



THE BULGARIAN ECONOMY

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**REPORT BY
THE CENTER
FOR ECONOMIC
DEVELOPMENT**

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The Center for Economic Development (CED) is a Bulgarian non-governmental research institute in the area of economic policy, established in 1997. Its goal is to support the economic development of Bulgaria through encouragement of public debate on economic issues and development of economic policy options.

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ABBREVIATIONS USED

AASMEA.....	ACT ON AMENDMENTS TO THE SMALL AND MEDIUM-SIZED ENTERPRISES ACT
AD.....	JOINT-STOCK COMPANY
AEAF	AGENCY FOR ECONOMIC ANALYSIS AND FORECASTS
APOS.....	ACT ON PUBLIC OFFERING OF SECURITIES
ARARACEA.....	ACT ON RESTRICTION OF ADMINISTRATIVE REGULATION AND ADMINISTRATIVE CONTROL ON ECONOMIC ACTIVITY
ASME	AGENCY FOR SMALL AND MEDIUM-SIZED ENTERPRISES
BAAT	BULGARIAN ASSOCIATION FOR ALTERNATIVE TOURISM
BAS	BULGARIAN ACADEMY OF SCIENCE
BATA.....	BULGARIAN ASSOCIATION OF TOURIST AGENCIES
BCCI.....	BULGARIAN CHAMBER OF COMMERCE AND INDUSTRY
BDU	BULGARIAN DOCTORS' UNION
BEIA.....	BULGARIAN EXPORT INSURANCE AGENCY
BNB	BULGARIAN NATIONAL BANK
BNR.....	BULGARIAN NATIONAL RADIO
BNT	BULGARIAN NATIONAL TELEVISION
BSE	BULGARIAN STOCK EXCHANGE
BTC	BULGARIAN TELECOMMUNICATIONS COMPANY
CAP	COMMON AGRICULTURAL POLICY
CEE	CENTRAL AND EASTERN EUROPE
CEFTA.....	CENTRAL EUROPEAN FREE TRADE AGREEMENT
CHPP.....	COMBINED HEAT AND POWER PLANT
COCA	COMPANY UNDER THE OBLIGATIONS AND CONTRACTS ACT
CoM.....	COUNCIL OF MINISTERS
CoMD	COUNCIL OF MINISTERS' DECREE
CPC.....	COMMISSION FOR PROTECTION OF COMPETITION
EA.....	EMPLOYMENT AGENCY
EA.....	ENERGY ACT
EAD	SINGLE- PERSON JOINT-STOCK COMPANY
EAPT	EXECUTIVE AGENCY FOR PROMOTION OF TRADE
EASMEP	EXECUTIVE AGENCY FOR PROMOTION OF SMALL AND MEDIUM-SIZED ENTERPRISES
EC.....	EUROPEAN COMMISSION
EDC.....	ELECTRICITY DISTRIBUTION COMPANY
EEA.....	ENERGY EFFICIENCY ACT
EIA.....	ENVIRONMENTAL IMPACT ASSESSMENT
EU.....	EUROPEAN UNION
FIA.....	FOREIGN INVESTMENTS AGENCY
FR.....	FISCAL RESERVE
FSC	FINANCIAL SUPERVISION COMMISSION
GDP.....	GROSS DOMESTIC PRODUCT
GS	GOVERNMENT SECURITIES
GVA	GROSS VALUE ADDED
HEI.....	HYGIENE AND EPIDEMIOLOGICAL INSPECTORATE
HPP	HYDRO POWER PLANT
IBA.....	INVEST BULGARIA AGENCY
ICT.....	INFORMATION AND COMMUNICATION TECHNOLOGY
IMF	INTERNATIONAL MONETARY FUND
IT	INFORMATION TECHNOLOGIES
MAF	MINISTRY OF AGRICULTURE AND FORESTRY
MDP.....	MUNICIPAL DEVELOPMENT PLAN
MEER	MINISTRY OF ENERGY AND ENERGY RESOURCES
MEW.....	MINISTRY OF THE ENVIRONMENT AND WATER
MLSP.....	MINISTRY OF LABOR AND SOCIAL POLICY
MoE	MINISTRY OF ECONOMY

ABBREVIATIONS USED

MoF	MINISTRY OF FINANCE
MoH	MINISTRY OF HEALTH
MRDPW	MINISTRY OF REGIONAL DEVELOPMENT AND PUBLIC WORKS
MTC	MINISTRY OF TRANSPORT AND COMMUNICATIONS
NAMRB	NATIONAL ASSOCIATION OF MUNICIPALITIES IN THE REPUBLIC OF BULGARIA
NEC	NATIONAL ELECTRICITY COMPANY
NGO	NON-GOVERNMENTAL ORGANIZATION
NHIF	NATIONAL HEALTH INSURANCE FUND
NMB	NAVIGATION MARITIME BULGARE
NPISH	NON-PROFIT INSTITUTIONS SERVICING HOUSEHOLDS
NPP	NUCLEAR POWER PLANT
NRA	NATIONAL REVENUE AGENCY
NRPD	NATIONAL REGIONAL DEVELOPMENT PROGRAM
NSI	NATIONAL STATISTICS INSTITUTE
NSSI	NATIONAL SOCIAL SECURITY INSTITUTE
OECD	ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
OPF	OCCUPATIONAL PENSION FUND
PA	PRIVATIZATION AGENCY
PIC	PENSION INSURANCE COMPANY
PIC	PENSION INSURANCE COMPANY
PIT	PERSONAL INCOME TAX
PPA	PUBLIC PROCUREMENT ACT
PPPCA	PRIVATISATION AND POST-PRIVATISATION CONTROL ACT
RB	REPUBLICAN BUDGET
RDS	REGIONAL DEVELOPMENT STRATEGY
SERC	STATE ENERGY REGULATORY COMMISSION
SHEI	STATE HIGHER EDUCATION INSTITUTION
SME	SMALL AND MEDIUM SIZED ENTERPRISES
SMEA	SMALL AND MEDIUM-SIZED ENTERPRISES ACT
SR	STRUCTURAL REGULATION
SVSC	STATE VETERINARY SANITARY CONTROL
TIPC	TAX-INSURANCE PROCEDURE CODE
UDB	UNION OF DENTISTS IN BULGARIA
UNDP	UNITED NATIONS DEVELOPMENT PROGRAM
UPF	UNIVERSAL PENSION FUND
USAID	UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
VAT	VALUE ADDED TAX
VPF	VOLUNTARY PENSION FUND
WTO	WORLD TRADE ORGANIZATION

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The positive development of the Bulgarian economy continues. Accelerated growth of GDP, foreign trade and foreign investment inflow is observed against the background of preserved price stability and balanced public finances. The positive dynamics in the financial sector persists. Some steps in the enterprise policy, the regional policy and the policy in the energy, high technology and communications sectors can be given positive assessment. The Estat index of business climate in Bulgaria reached record breaking values.

While employment and unemployment indicators register positive development, the slow labor productivity improvement prevents any sizable increase of the low yet incomes and living standards. At the same time the business increasingly registers shortage of qualified labor.

Bulgaria's economic growth remains accelerated at 6.0 per cent on an annual basis for the second quarter of 2004 against the high value of 5.3 per cent in the first quarter. **Industry** remains the most dynamic value added generator of the three basic economic sectors, registering the highest growth of 7.6 per cent and a continuing upward trend. **Investments** are determinative of the characteristic of GDP's growth in terms of consumption. While in the second quarter investments in fixed capital register smaller increase on an annual basis against the growth in the first quarter (21.4 per cent), their share in GDP consumption exceeds 20 per cent. Certain delay in the growth of final consumption is observed, mostly owing to the nearly **twice lower growth of individual consumption**. Export and import of goods and services register nearly identical growth and the share of the negative foreign trade balance of goods and services in GDP remains at about -13 per cent in the second quarter.

While indications confirming that the Bulgarian economy is entering a phase of sustainable accelerated growth are insufficient yet, the high growth rates observed in the first half of the year could contribute to higher annual growth compared to the official budget estimates.

Foreign trade preserves sustainable growth rates, with growth in imports continuing higher than growth in exports and the negative balance registering increase. The relationship between the growth in imports and the higher inflow of **foreign investments** is more clearly outlined. To these should be added the need of some Bulgarian companies to implement ambitious investment programs in their pursuit of technological renovation and efforts to meet European market requirements with a view to preserve their competitiveness following Bulgaria's accession to the EU. This interdependence gives grounds to assume that in the future imports will remain significantly higher than exports.

The latest regulated increase of electricity and thermal energy prices in July contributed by about 1 percentage point to the

1.2 per cent increase of monthly **inflation**. Following the slight deflation in August, inflation in September stood at 0.9 per cent, and the accumulated price increase for the first nine months of the year is 1.9 per cent against December last year.

The positive trends in the parameters of **employment and unemployment** outlined in the quarterly labor force survey persist. Employment by sectors data allow to assess productivity of labor growth measured as gross value added per employed person. Productivity in the services sector registers the highest growth.

According to the labor force survey, in the second quarter unemployment registers a decrease and stands at 12.0 per cent. The permanent downward trend in unemployment is also confirmed by the Employment Agency data – at the end of August the coefficient of registered unemployment reached its lowest level and stood at 11.94 per cent.

In July the **Estat index** of business climate registered again a peak value rising up to +5.27. This value is a combination of the improved condition of the companies and the business environment and a slight decrease in investment attitudes. For the first time the "State" component of the index moved from the negative to the neutral part of the scale. Well outlined signs of improved business environment are in place. Increasingly higher number of entrepreneurs views taxes as just and bearable. Certain decline is observed in investment attitudes, which is mainly attributable to the lower propensity to make risk investments in activities other than the core business, as well as to problems with the labor force quality. The upward trend in the confidence in banks continues and companies begin to overcome, through at a slower pace, the persistent shortage of funds in their day-to-day business. In summary, a conclusion can be made that for the first time the survey registers indications of possible permanent improvement of the business climate in Bulgaria in a mid-term perspective.

In 2004 the investment activity in the economy registers improvement. This process is a result of the predictable and smooth business environment observed recently, as well as of real Government efforts to **encourage investments** and to eliminate some **administrative barriers**. This resulted in record breaking values of foreign investments on an annual basis. But the Government has what to do yet to increase domestic economic investments, mainly in terms of facilitating the introduction of quality standards, promoting innovative projects, integrating property registration systems and reducing further the administrative barriers to the business. The institutional framework of the enterprise policy was developed further with **Rules on the Structure and Operation of the new Executive Agency for Promotion of SMEs**. Like with the previous structure of the agency, the rules imply certain shortage of resources for the planned commitments of the agency. This makes the question of the private provision of the agency's

public services even more imperative (which is laid down in SMEA but not in the Rules on the Structure and Operation).

The new **Public Procurement Act** took effect since 1 October 2004. A number of bylaws to the act were passed in the previous months. In the autumn the Government also approved Rules and Statute of the Arbitration Court at the Public Procurement Agency. The adopted new public procurement regulation should be given a positive assessment and it is a prerequisite for greater clarity, transparency and efficiency in this sphere in the future.

The access to finance of Bulgarian enterprises registered further improvement. Another positive development is also **the fulfilled annual privatization program** of PA. PA's fulfilled annual program and the small number of state-owned companies subject to privatization allow for the conclusion that the privatization of the state-owned property in Bulgaria is coming to an end, which is also supported by the European Commission's Regular Report on the progress of Bulgaria. The withdrawal of the state from a number of infrastructure sectors is slower than expected. The delayed development of the infrastructure sectors, **particularly the transport infrastructure**, calls for increased financing from both the Government and private investors.

Overall, very good execution of the consolidated fiscal program is observed in the first seven months of 2004. According to Ministry of Finance data, as at 31 June 2004 **the surplus on the consolidated fiscal program** registers sizable increase against the same period of 2003, standing at BGN 976.7 m. As at end of July 2004 **revenues** and aid stand at BGN 8 996.5 m, or 62.3 per cent of the total annual amount planned in the consolidated budget program. **Expenditures** for the period amount to a total of BGN 8 019.8 m, or 54.6 per cent of the annual amount of expenditures under Budget 2004. Regarding the constituent budgets, the national budget (particularly in the part for ministries and institutions), as well as the budgets of the social security funds and the municipalities register more significant expenditures. According to our estimates, by year end the surplus on the consolidated fiscal program, which is mainly a result of the excess execution of tax revenues, will exceed BGN 1 b.

As at end of July, as a result of the operation of advance payment of the obligations on discount Brady Bonds, **the fiscal reserve** registers decrease by BGN 1 062 m against the previous month and stands at BGN 4 096.5 m, of which BGN 3 663 m in deposits in BGN and BGN 2 092 m in foreign exchange assets.

At the end of July 2004 total **government and government-guaranteed debt** amounts to BGN 16 089.2 m at BNB central exchange rates for the lev at 30 July 2004. Total debt registers sizable decrease of BGN 1 243.6 m against end of April. The

registered decrease of debt is mainly due to the operation of advance payment of DISC Brady Bonds at the end of July. The accounted exchange rate variations in the reviewed period are an additional factor along these lines. At comparable data, the **debt-to-GDP ratio** has dropped from 45.6 per cent at the end of April 2004 to 42.4 per cent at the end of July. Total debt registers decrease of BGN 1 377.5 m against end of July 2003. According to Ministry of Finance data, as at end of July **foreign debt** has dropped down to EUR 6 950.8 m (against EUR 7 603.1 m at the end of April), with government debt standing at EUR 6 491.7 m (against EUR 7 152.8 m at the end of April), and government-guaranteed debt standing at EUR 459.1 m (EUR 450.3 m as at 30 April 2004). According to Ministry of Finance data, as at 31 July 2004 **domestic debt** stands at BGN 2 494.7 m. Total domestic debt registers increase of BGN 32.4 m against end of April 2004.

In the next months debt amount will be probably determined again by the dynamics of the Euro exchange rate to the US Dollar and the change in the foreign exchange structure. In any case the total debt-to-GDP ratio indicator will remain within the Maastricht criteria for membership to the Economic and Monetary Union and will probably preserve its smooth downward trend.

The lasting and sustainable trend of real decrease of unemployment in Bulgaria is preserved in all months since the beginning of 2004. The favorable situation on the **labor market** is conditioned by the positive economic dynamics, the higher demand of seasonal labor and the continuing large-scale implementation of government subsidized employment programs. But the future employment of such large-scale active labor market policy instruments requires monitoring and impact assessment on the basis of uniform national criteria.

Unlike the previous year, the tendency of increase, though negligible, of the **real incomes of Bulgarians** was not preserved in 2004. While employment registers improvement, the incomes and the living standards of Bulgarians remain at low levels with no signs of noticeable improvement in a close perspective. The new jobs are not high-pay ones, in other enterprises and sectors workers have not been paid for a long time, although they are not officially dismissed from work.

In the recent months the most widely discussed pension system topic was the proposal of the new chairman of NSSI's Supervisory Board to **allocate funds from the fiscal reserve to NSSI**, which should be actively managed with a view to raise pensions and reduce the social security burden for employers and insured persons in the future. The partial capitalization of NSSI could prove a successful and politically acceptable move to guarantee the financial sustainability of the pension system in a long-term perspective with clear and positive economic and social consequences. But such an important step should

be first carefully analyzed by experts and put to a wide public debate.

The syndicates-employers negotiations of the **new minimum social security thresholds** for 2005 are coming to an end and an average increase of these thresholds by 7.5 per cent is expected. NSSI's idea to introduce differentiated rates for employers in respect of accident at work and occupational illness contributions can be given positive assessment and the new way of distribution of the social security burden is expected to encourage largely company investments in improved working conditions.

Assets in pension funds now exceed BGN 615 m, but this huge financial resource is not yet adequately used to efficiently improve the competitiveness of the Bulgarian business and the economy as a whole. The tendency to have the relative share of UPF assets in the aggregate pension assets increased at the expense of the relative share of VPF assets, as well as to have pension assets invested predominantly in government-issued or government-guaranteed securities and in bank deposits, which has been observed for a year and a half now, continues. The market concentration on the social security market remains high, but the new criteria for official reallocation of the insured persons by NSSI and the introduced daily evaluation of pension assets management results achieved by the different pension insurance companies are expected to increase the competition on this market. While the new MoF's Ordinance No. 6 of 13 July 2004 allows for investment of pension assets in foreign securities bearing higher risk, investments abroad are not expected in the near future owing to the more attractive Bulgarian securities.

The chaos in the **health care sector** persists and the main reason for this unfavorable fact is the absence of a clear vision of how to develop the health reform and implement an adequate health policy in Bulgaria. The new hospital care financing model implemented since 2004 proved inefficient, as hospitals continue to accumulate sizable debts relying on additional subsidy from the state budget to cover such debts. Extending the deadline for determining the positive list of medicines till 30 November 2004 creates real danger of not concluding the negotiations on the new National Framework Agreement 2005 on time to make it effective since the beginning of 2005. The passed Health Act which repealed the Public Health Act effective for 30 years raised a few fundamental problems topical for the development of the Bulgarian health care model, but the important discussions on these problems are to be held yet.

The section on the **environmental policy** contains comments on the draft new National Environment Protection Strategy put forward for discussion, which defines the basic priorities and goals to be achieved by 2014. As regards the amendments to the environmental legislation in the period covered by the report, the focus is placed on the newly passed legislation

on nuclear safety, radiation protection and hazardous waste management. This is an area in which the latest European Commission Report on the progress of Bulgaria contains special recommendations in the part on transposing, implementing and monitoring environmental legislation.

The banking system preserves a dominant role in Bulgaria's financial sector and financial intermediation. The banking system generally continued to increase its assets, deposits and net current profit. Deposit base growth and assets growth are respectively a factor for and an indicator of more difficult delay of credit growth. Credit expansion continues practically without slowing since the beginning of 2004 – both absolute growth and practically preserved growth rate on an annual basis are observed. For example, in the first eight months of 2004 newly contracted loans register a growth of 30.02 per cent against the same period of 2003. The condition of the credit portfolio remains good, however discussions on the relationship between imports growth, current account deficit accordingly, and the credit expansion continue. New measures to limit credit growth were discussed during the visit of IMF's mission in September.

The good development of Bulgaria's **capital market** continued in 2004, despite the limited yet contribution of this market in total financial intermediation – as at end of September 2004 total market capitalization of the Bulgarian Stock Exchange – Sofia AD stood at 9.4 per cent of GDP's updated forecast for 2004. Trade on the Bulgarian Stock Exchange AD is active, with turnover, market capitalization and the stock exchange index registering growth on an annual basis so far. Trade in compensatory instruments and investment vouchers remains active with compensatory instruments price reaching record breaking values. While the indicators register improvement, there is a need to point out the absence of clear perspective of the market in a long-term aspect. Thus the need for institutions and market actors to take active measures to preserve and expand the existing potential has come to the front. FSC experts developed draft Amendments to POSA with a view to align the Bulgarian legislation with the *acquis* in the area of securities and to improve the existing Bulgarian regulations. Proposed amendments include taking the state interest in Bulgarian Stock Exchange – Sofia AD and Central Depository AD out of the "prohibitive" list under PPCA whereby this interest is automatically advertised for sale.

Development of the regulatory framework in the **energy sector** continues. This process is expected to get finalized this year. SERC reported serious investor's interest in the gas distribution sector which is a positive sign for the long-term development of this sector in Bulgaria and enhanced positions of natural gas as a basic energy source. Discussions on the future development of Bulgaria's nuclear energy sector continue and the focus is now placed on the capital structure of the future Belene NPP Company. The upward trend of petrol and petrol product prices continues, which will have a negative effect on the costs of

some companies in the sector which intensify their activity in the winter season.

In the **transport** sector the major events for the automobile transport were dictated by the adopted and implemented European legislation which resulted in withdrawal of the automobile transport licenses of 826 Bulgarian companies. The adopted conditions for the concessioning of sea airports and the strategy for the privatization of Bulgaria Air approved by the Council of Ministers were a step forward in creating conditions for the entry of private capital in airport activities and air transport. The news about the concessioning of Trakia and Hemus motorways generated some surprise and require more profound analysis. Development of the issues concerning the concessioning of port activities is to be seen yet.

After a delay of over two years, in August the **high technology and communications** sector witnessed the adoption of Bulgaria's Innovation Strategy. The objective of this document is to improve the environment for development and introduction of innovative products in Bulgaria, which in turn should have a positive effect on the competitiveness of the Bulgarian economy. A Strategy on the introduction of universal mobile telecommunication systems was adopted in the past months and a draft update of the Telecommunications Sector Policy as of 2004 was developed. The objective of the two documents is to update the development framework of the telecommunications market in line with the modern challenges in the sector.

The last months confirmed the positive development of **tourism**. According to Ministry of the Economy data, in the period January – August Bulgaria was visited by 3.3 m foreign nationals, of which 2.9 m arrived for holiday or vacation. Against the average growth of 18.4 per cent in the number of foreign tourists in the period January – August, EU countries register an increase of 28.3 per cent. The number of Bulgarians traveling abroad registers increase as well. In the period January – August the balance in tourism reached EUR 558.2 m, accounting for 2.9 per cent of GDP. The chaotic disorderly construction in the big sea resorts remains a top problem of tourism. A risk of oversupply of beds emerges gradually. The delayed construction of new projects also creates problems which have a negative effect on the image of Bulgaria and will probably make foreign tour operators to avoid prepaying tourist holidays. Along with the sizable investments in the infrastructure along the Black Sea coast, opportunities are sought to modernize the base in the mountain resorts as well. By CoM's Decree No. 203 the Executive Agency for National Tourist Advertising was transformed into a Tourism Agency at the Minister of the Economy. Talks of the need to pass a Black Sea Coast Act have intensified in recent months.

While the good wheat crop contributed to the higher share of **agriculture** in Bulgaria's GDP and GVA compared to the second quarter of 2003, the tendency of gradual decrease of

this share is preserved. This has effect on trade – export of agricultural goods registered considerable increase against the first three months as well as against the second quarter of 2003 whereby the positive trade balance for this commodity group was restored. The implemented agricultural policy aimed at restructuring the sector in line with EU's Common Agricultural Policy has a positive effect, but it becomes increasingly clear that the development of agriculture lags far behind the needs of related sectors like packing industry, wine production and textile. The production capacities of the enterprises in these sectors cannot be fully utilized because of the shortage of raw material. Hence the need to accelerate reforms, particularly in the area of rationalized production and organization structures, technological building of farms and professional training of staff.

In the area of **regional policy** the work on applying the provisions on implementing regional planning mechanisms laid down in the Regional Development Act continued in the last months. A couple of important documents were published to support regions and municipalities in developing their strategic and planning documents. The first document – Methodological instructions on developing regional development strategies – will help regional administrations to successfully develop their regional strategies. The second document – Methodological instructions on the development of municipal development plans – will facilitate municipal governments in the process of bringing the existing development plans in line with the new Regional Development Act. Efforts to enhance the capacity of local authorities to develop projects for successful utilization of the resources from the European funds and to improve local self-government continued as well.

Gross Domestic Product

Domestic economic growth continued accelerating. In the second quarter of 2004 gross domestic product was up 6.0 per cent on an annual basis following the high growth of 5.3 per cent in the first quarter.

However, valued added created by the economy as a whole grew at a slower pace (5.6 per cent in the second quarter against 6 per cent in the first quarter compared with the same period of last year). Gross domestic product grew faster than value added, consistent with 1.1 percentage point contribution of the growth (8.7 per cent) of position adjustments¹. The high growth in adjustments is probably due to high growth in both components of adjustments – value added tax and excise duties.

On the supply side, **industry** continued to be the most dynamic driver of value added among the three economic sectors. Value added in industrial sector grew most, by 7.6 per cent, and continued growing faster (against 5.9 per cent in the same period of last year and 6.4 per cent in the first quarter). Value added growth in services sector slowed down at 5.4 per cent in the second quarter against 6.2 per cent in the first quarter. Nevertheless, it is much higher than growth in the second quarter of last year (3.8 per cent). Although services grew more slowly than industry, their high share in GDP accounted for the largest contribution of the sector – 2.8 percentage points in overall economic growth (2.1 percentage points is the industry's contribution). The agricultural sector grew, though minimally, by 0.9 per cent in the second quarter (against 1.2 per cent in the first quarter, following a drop last year).

Private sector grew fast, at 11.3 per cent value added in the second quarter of 2004 (against 7.4 per cent in the same period of last year and 8.8 per cent in the first quarter).

On the demand side, **investment** was the key factor behind GDP growth. Although investment in fixed assets (6.3 per cent on an annual basis) grew much more slowly in the second quarter compared with the first one (21.4 per cent), their share in gross domestic product use (21.6 per cent) did not decline (against 21.4 per cent in the same period of last year and 18.7 per cent in the first quarter). As early as the third quarter of last year the change in inventories had a more sizeable share in

the structure of gross capital formation, which sustained high in the second quarter of 2004 (14.5 per cent against 6.2 for the same period of last year). This could not be assumed as negative development because, based on NSI information, the increase in inventories is due mainly to the raw materials and work-in-progress components.

In the structure of gross capital formation financing in the economy the gross national saving/external saving ratio is 60/40 in the second quarter of 2004 against a ratio of 40.6/59.4 for the same period of last year². In annual terms, changes in the ratios of the components of gross capital formation financing to GDP and changes in the structure of financing clearly indicate **the growing importance of the inflow of external financing** for intensification of the investment process in the country combined with higher households' final consumption (Table 1).

Table 1. Gross capital formation financing

Gross capital formation financing, % of GDP						
	Total	Gross national saving				External saving
		Total	Gross domestic saving	Current transfers from abroad, net	Income from abroad, net	
2004 ^{1/}	23.8	12.7	10.6	4.1	-2.0	11.2
2003	21.7	13.0	12.0	3.5	-2.5	8.8
2002	19.8	15.0	13.2	3.5	-1.7	4.8
2001	20.7	14.6	13.1	3.7	-2.2	6.1
2000	18.3	12.7	12.9	2.3	-2.5	5.6
1999	17.9	13.1	12.1	2.3	-1.4	4.8
1998	16.9	16.6	17.1	1.8	-2.3	0.2
1997	9.9	13.3	14.5	2.3	-3.5	-3.4
1996	8.1	10.9	13.5	0.8	-3.4	-2.8

* Half-year. Balance of payments, published on 30.08.2004, GDP, published on 20.09.2004

Source: BNB, NSI and own calculations.

Components of gross capital formation financing, total financing = 100, %						
	Total	Gross national saving				External saving
		Total	Gross domestic saving	Current transfers from abroad, net	Income from abroad, net	
2004 ^{1/}	100.0	53.2	44.5	17.0	-8.3	46.8
2003	100.0	59.7	55.1	16.0	-11.4	40.3
2002	100.0	75.7	66.6	17.6	-8.5	24.3
2001	100.0	70.4	63.4	17.8	-10.7	29.6
2000	100.0	69.6	70.7	12.6	-13.8	30.4
1999	100.0	73.0	67.8	12.9	-7.7	27.0
1998	100.0	98.6	101.4	10.7	-13.4	1.4
1997	100.0	134.6	146.3	23.5	-35.1	-34.6
1996	100.0	134.0	166.6	9.5	-42.1	-34.0

1/ Half-year. Balance of payments, published on 30.08.2004, GDP, published on 20.09.2004

Source: BNB, NSI and own calculations

² To characterize gross capital formation financing we use the following relations between macroeconomic aggregates:

Gross capital formation financing = Gross national saving + External saving

Gross national saving = Gross domestic saving + Current transfers from abroad, net + Income from abroad, net

Gross domestic saving = GDP - Final consumption

External saving = Current external balance

¹ In accordance with the methodology of Bulgarian national accounts, the following methodological relation is used for calculating GDP at market prices by production approach:

GDP = Gross value added total for the economy at basic prices + Adjustments

Adjustments = + Net taxes (taxes less subsidies) on products – Financial intermediaries' services indirectly measured (FISIM).

Net taxes on products – at the adopted method of valuating output and value added – are the taxes attributed directly to the product produced or sold (excises, customs duties, VAT), less relevant subsidies on products.

Financial intermediaries' services indirectly measured (FISIM) are calculated as the difference between interest received and paid by them. FISIM is not allocated by sector of consumers, but the entire production is treated as intermediate consumption by a nominal sector with production equivalent to zero and a negative value added equal in amount but with opposite sign to intermediate consumption. Thus value added for all sectors is adjusted (decreased) as a whole by this value.

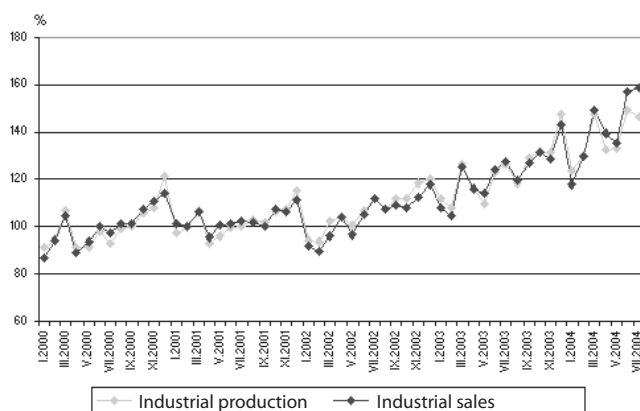
External saving = Current external balance

Final consumption growth dynamics slowed down further (4.2 per cent in the second quarter against 8 per cent in the same period of last year and 5.2 per cent in the first quarter), mainly due to almost **twice slower growth in individual consumption** (4.3 per cent in the second quarter against 8 per cent in the second quarter of last year). This reflected on its lower share in GDP at 88.0 per cent (against 90.1 per cent for the same period of last year and 91.0 per cent in the first quarter).

Export and import of goods and services grew in real terms at very close rates (10.9 and 11.3 per cent respectively on an annual basis). For this reason the deficit in the foreign trade balance of goods and services in GDP in the second quarter (-13.2 per cent) sustained from the first quarter (-13.3 per cent) and worsened slightly compared with the corresponding period of last year (-12.9 per cent).

In assessing the possibility for further acceleration of economic growth in the second half of the year a negative indication is the July decline of the general confidence indicator for the economy compared with its April level³, consistent with lower confidence indicator in construction and consumer confidence indicator. A positive sign is the dynamics of the general business climate indicator⁴, which rose in July and in August sustained at its highest level in recent years. This is mainly attributable to business climate evaluations in industry, regardless of the less optimistic evaluations of the level of external orders. Industrial sales grew in July but production declined on the previous month (Figure 1). At the end of August construction managers' expectations were about preservation of construction activity and employment in the next months, but not increase. The dynamics of business climate in retail trade and services is upward. According to retailers, however, demand is continuously perceived as insufficient, despite the upward trend in sales revenues in trade as a whole since the beginning of the year.

Figure 1. Industrial production indices and industrial sales indices, (base 2000 = 100, %)



Source: NSI. Published on 10 September 2004.

Although there are not sufficient indications confirming that the Bulgarian economy is entering a stage of sustainably accelerating growth, high growth in the first half-year will contribute to **higher annual growth than the official forecast** set in budget estimates.

Foreign trade⁵

The second quarter of 2004 is the strongest in terms of foreign trade. **Exports** amounted to EUR 1,895.1 million, by 17.4 per cent more than in the second quarter of 2003, and **imports** grew by 18.8 per cent to EUR 2,925 million. **The deficit** of EUR 1,713.8 million for the half-year (exports FOB – imports CIF) is also the **highest so far**, an increase of 33 per cent on the first-half of 2003. Such a development is not surprising and does not cause concern, given the surplus in trade in services and the large inflow of foreign investment. Surprising in terms of imports is the lower share of energy resources (from 18.8 per cent to 16.8 per cent for one year) and the insignificant increase in their value (by 0.9 per cent) consistent with higher prices in the international market. This reveals a favorable structure of the Bulgarian energy sector, which appears to be resilient to external shocks.

At the same time, the **share of investment goods in imports grew**. Their volume increased by almost 20 per cent in the second quarter of 2004 compared with the same period of previous year. This is a direct result of intensified investment process in the country. Machines and equipment contribute almost half of imports and vehicles account for another 28 per cent. All this entails output expansion and sustained high economic growth. **Imports of consumer goods** increased even more (by 34 per cent on a quarterly basis and by 29 per cent on a semiannual basis), a direct result of higher consumer demand in the domestic market, consistent with higher incomes and rapid lending development. The real reason, however, is satisfaction of long postponed needs.

The four major commodity groups, i.e. consumer goods, raw materials, investment goods and energy resources, retained almost unchanged share in the **commodity structure of exports**. Raw materials and particularly metals grew most (31.7 per cent) in the half-year, accounting for 45 per cent of exports in this commodity group. At the same time, exports of consumer goods (over 60 per cent being clothing and footwear) grew at a more moderate pace (8.1 per cent), with foods and furniture gaining momentum recently.

³ Source: NSI Consumer Survey. Quarterly periodicity. Published on 12.08.2004. The composite confidence indicator of the European Commission is the average weighted of four confidence indicators – in industry (with 40% weight), in construction, retail trade and consumer confidence indicator, each of 20% weight. For more information see: <http://www.nsi.bg/Economy/Economy.htm>

⁴ Source: NSI business surveys. Monthly periodicity. Published on 27.08.2004. The general business climate indicator is average weighted arithmetic mean of four sectoral indicators of business climate – in industry, construction, retail trade and the services sector, and the business climate indicator in the services sector is included in the overall time series since May 2002. For more information see: <http://www.nsi.bg/Economy/Economy.htm>

⁵ According to BNB data, published at the end of August 2004.

In terms of **geographic structure**, the trend of growing EU share sustained. For example, **with EU expansion the share of exports for the half-year is already 60 per cent, and 54.8 per cent in imports**. For the group of the 15 Member States of EU this share is 56 per cent in exports and 49 per cent in imports. There is no surprise in exports to major partner countries – Italy, Greece and Germany – and in the same countries but in another order in terms of imports (Germany, Italy, Greece). The share of Balkan countries in exports is approximating one fifth and marks a considerably higher growth (by 22.2 per cent in the first half-year) compared with overall export growth. Imports from these countries also grew at faster pace (24 per cent), but their share in imports remained below 10 per cent. The upward trend in trade with these countries will probably sustain in the future, given the high potential for cooperation development, including regional exchange of goods.

Foreign direct investment⁶

Table 2. Inflow of foreign direct investment in Bulgaria

	Q1	Q2	Q3	Q4	6M	9M	Year
In % of GDP for corresponding period							
2004 ¹	8.5	14			11.4		
2003	7	9.6	5.7	6.6	8.3	7.3	7.1
2002	7.1	10.1	1.3	5.9	8.7	5.8	5.9
2001	10.3	4.4	3.7	6.1	7.3	5.9	5.9
2000	4.5	5.5	6.4	14.7	5	5.5	8.1
1999	5	5.7	5.1	9.2	5.3	5.2	6.4
1998	7.4	2.4	2.6	4.9	4.8	4	4.2
1997	3.2	11.4	2.7	3.1	8.5	5.6	4.8
1996	0.4	0.4	0.6	3.1	0.4	0.5	1.6
In % of external saving, %							
2004 ¹	69.1	138			101.9		
2003	66.2	70.5	-173.1	42.7	68.7	118.2	81.2
2002	89.9	205.7	-18.6	41.7	136.8	467.1	121.9
2001	140	81.9	397.8	55.2	114.7	138.8	97.1
2000	36.7	188.1	-327.3	143.3	68	149.3	146.2
1999	53.1	95.6	-564.2	142.9	70.4	124.3	131.4
1998	515.1	-77.4	-74	81.5	-529.3	-204.9	1 807.90
1997	-35	-1 517.90	-70.6	-116.4	-230.4	-148.2	-140.2
1996	20	-10.6	-15.4	-103.3	-39.6	-20.1	-57.6

1/ Half-year. Balance of payments, published on 30.08.2004, GDP published on 20.09.2004.

Source: BNB, NSI and own calculations.

As it appears, **2004 will be a record one for investment inflow**. The reasons for this development are assignment of

an investment rating of the country, successful privatization transactions and pro-active government policy – adoption of the Investment Act and design of a strategy. The second quarter of 2004 is probably the most successful one in terms of foreign direct investment inflow – its volume grew by 180 per cent on the previous quarter and by 160 per cent on the same quarter of 2003; semiannual growth is 50 per cent. The volume of EUR 978.6 million reached at the end of the half-year accounts for 5 per cent of GDP and it is possible to reach EUR 2 billion for the whole year. The most significant feature of the investment structure is the faster **growth of investment in share capital** at the expense of other capital. In the first half year of 2003 investment in share capital comprised merely 29.5 per cent against 65 per cent in other capital and now this ratio is 55 per cent to 39 per cent. The reasons are the privatization of BTC and the increased capital of Mobitel as well as the reduced share of borrowed other capital – EUR 381.8 million for the six months of the year against EUR 420.5 million a year earlier. These are “green field” investments and investments in business expansion of companies operating in the country, but they also accommodate credit movements and 2003 was a record one in this respect.

Inflation

By the end of the first half-year cumulative inflation almost melted away to 0.2 per cent on December 2003 as a result of monthly deflation of 1.8 per cent in June. According to AEAf estimates⁷, June deflation is due mainly to lower prices of foodstuffs (by 4.22 per cent and 1.62 percentage point contribution). The only appreciation is in market services, at less than 0.5 per cent.

Thin inflation dynamics between January and June, when the new excise rates of tobacco products and fuels came into force, reflects the market. In July a monthly inflation of 1.2 per cent occurred, consistent with already planned administrative price rises in electricity and heat energy. Their contribution is 1 percentage point, while 0.2 percentage points are due mainly to 1.24 per cent rises in market services prices.

Producer price dynamics (industrial producer prices in domestic market) by mid-year also had a slight upward and downward fluctuation (in February and June). It depends mainly on the dynamics of producer prices of energy products.

At the end of August NSI business surveys did not report inflationary expectations in industry and in the services sector (without trade). In construction, however, expectations of higher selling prices were confirmed for a second consecutive month. Inflationary expectations increased in retail trade.

Employment and unemployment

In the second quarter of the year positive trends in the parameters of employment and unemployment outlined in data

⁶ According to BNB data, published at the end of August 2004.

⁷ Source: AEAf, a series of current overviews, Monthly Bulletin.

on labor force quarterly survey, conducted by NSI since early 2003 with a changed period of observation, continued.

Compared with the same period of last year the **number of economically active persons continued growing** (by 42700), due to the increased number of employed, by 93800 (by 3.4 per cent) and reduced number of unemployed, by 51200 (by 11.2 per cent).

Data about employment by sector allow assessment of the growth of **labor productivity**, measured as gross value added per one person employed. Productivity in the services sector grew most.

Table 3. Growth in number of persons employed, GVA and GVA per one person employed, second quarter of 2004 against second quarter of 2003, %

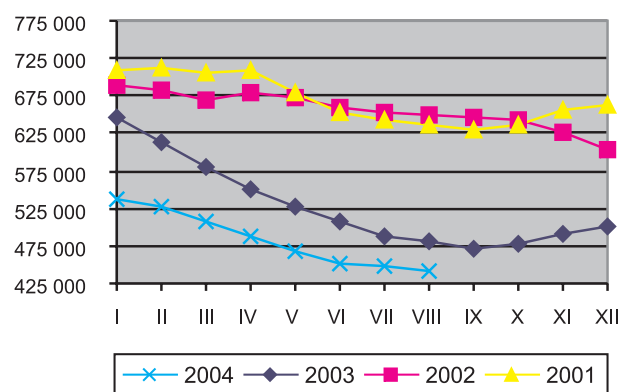
	Employed	GVA	GVA per 1 employed
Agriculture	-0.5	0.9	1.4
Industry	5.7	7.6	1.8
Services	2.7	5.4	2.6
Total for economy	3.3	5.6	2.3
Private sector	8.8	11.3	2.3

Source: NSI and own calculations.

The labor force survey estimates the number of unemployed in the second quarter of 2004 at 406100. The average number of registered unemployed with the Employment Agency however is higher: some 469000. In the second quarter the unemployment level fell to 12.0 per cent, according to the labor force survey.

Nevertheless, when comparing the data from the labor force survey and those of the Employment Agency unemployment has one-way dynamics. At the end of August the number of registered unemployed was 442000 and the unemployment rate hit a record low level, 11.94 per cent, since the beginning of 2001, according to the methodology of the EA, based on economically active population since the census in 2001.

Figure 2. Registered unemployed, number



Source: EA.

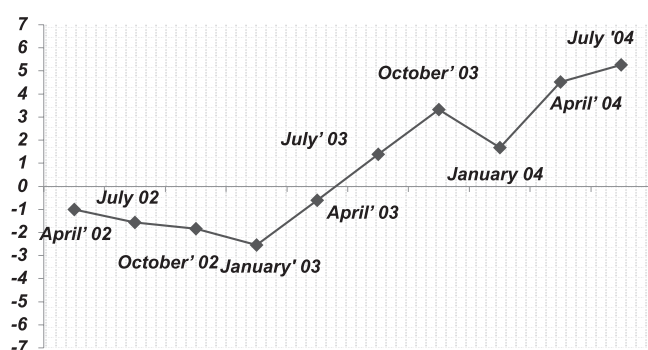
The Estat index of business climate in Bulgaria

In July the **Estat Index** of business climate registered a new peak as it reached **+5.27** (Figure 1)⁸. Since the beginning of 2003 each subsequent index value has been higher than the preceding one.

The ESTAT survey carried out in July shows the high internal dynamics of index components. The latest value is a mix of businesses' improved condition and business environment combined with a slight decline in investment intentions.

The "thriving" companies/ "sinking" companies ratio is exceptionally favorable – 16 per cent of all companies are in good shape and their managers expect it to further improve over the next quarter, while under 4 per cent are in a poor condition and their managers expect it to become even worse.

Figure 3. Business Climate Dynamics



The study outlined the following **trends and conclusions**:

- For the first time ever the component entitled "the State" crosses over from the negative to the neutral section of the scale. There are well-pronounced indicators of improvement in the business environment. However slowly, confidence in government policy, the work of the administration and the legislation is going up.
- An increasing number of entrepreneurs perceive taxes as being fair and affordable. This mostly applies to patent tax but also to profit tax rates.
- The average values for key resources such as finance, buildings, information and new technologies, Internet and communications are also higher.
- A slight decline is registered in investment attitudes; it can be accounted for mostly by the lower propensity for risk investments in activities other than the core business and also by issues related to the workforce quality.
- Confidence in the banking system continues to go up in spite of the slight decline in the number of those willing

to borrow. Taken as a whole, however slowly, companies are beginning to overcome the once-chronic shortage of financial resources for their usual business operations.

- For the first time the Estat Index survey registered serious and diverse indications of the considerable and lasting improvement in the business climate in Bulgaria in the mid-term perspective.

General condition of the business sector

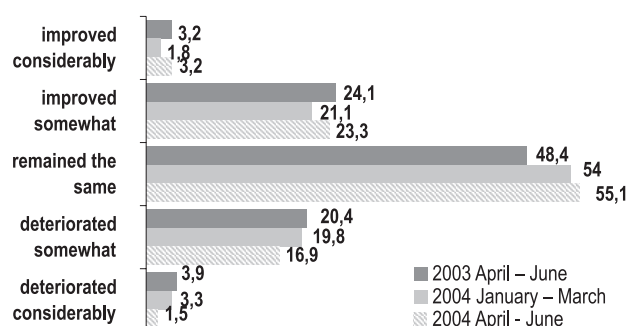
The value of Component I "Condition of the company" went up from **9.50** in April 2004 to **11.43** in July, 2004. Higher growth for this component was only registered in the period from January to April last year.

A record-breaking low – just 1.5 per cent, is the share of managers registering a significant decline in their business over the past three months (Figure 4). By comparison, 13.5 per cent of respondents chose that response in the winter of 2002.

Only 13 per cent of entrepreneurs describe the current condition of their business as "poor", while 2 years ago the share of negative assessments was twice as big. Such figures give us reason to conclude that there has been a considerable improvement in the condition of companies over the past years. In spite of the fact that there is evidence of the typical "beginning-of-summer" optimism, managers' opinions should not and cannot be accounted for by this factor alone.

Such growth must also not be ascribed to mere chance, to the way in which the sample was formed or to other factors of statistical nature. It is perhaps appropriate to remind the reader that the sample of companies surveyed for the Estat Index changes very slowly and in effect those surveyed in July are almost the same companies surveyed in the first months of this year.

Figure 4. In your opinion, did the condition of your business change?

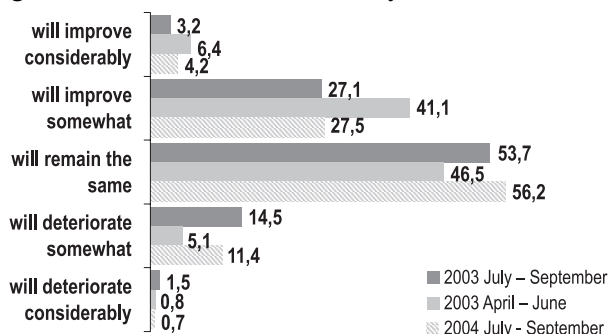


In July the share of those anticipating improvement in their business over the next quarter is lower by 13 per cent mostly because of managers who have responded that the condition of their companies will remain the same (Figure 5). The percentage

⁸ The survey was conducted in the period 1- 20 July 2004 among 409 companies and is representative at the "going concern" level. The sample criteria included the region, sector, number of employees and type of ownership. The methodology behind the index and the mathematical model were developed by the ESTAT Agency for Social and Marketing Surveys.

of those agreeing to the latter statement (56 per cent) has been among the highest ever registered since the study was first conducted. These figures show that the springtime euphoria gives way to a more sober assessment, which in its turn is marked by the managers' sense of sustainability of the current condition.

Figure 5. Will the condition of your business change?



The current study registers the highest average values over the last two and a half years for some business resources, namely buildings, financial resources, computers and software, new technology and information provision. The assessment of the quality of Internet connections is at its second highest level which was only exceeded during the first quarter of this year.

Also noteworthy is the improved availability of financial resources and the record-high share of 58 per cent who described the quality of this type of resource as good, very good or excellent.

An obvious progress has been registered by businesses in terms of information technology and communications.

The condition of enterprises' resources as registered by this study gives us grounds to forecast an even more considerable improvement in the remaining components of the business environment in the near future.

Table 4. Companies position compared to competitors, %

Number of competitive advantages	2003		2004		
	July	October	January	April	July
none	28.5	30.8	31.6	34.3	29.6
1	16.0	17.1	15.3	16.4	14.1
2	17.9	16.4	19.3	15.1	18.3
3	10.8	11.6	15.3	11.5	12.1
4	11.5	11.6	8.3	13.6	13.8
5	7.9	5.0	5.0	2.6	5.4
6	7.4	7.3	5.3	6.6	6.7

The share of businesses that responded they didn't have even a single competitive advantage is within the usual range, as well as the share of businesses whose managers responded that they outmatch the competition on all points. In the context of the

above fact very impressive are the 34 per cent of respondents who indicated they enjoy better positions as regards access to information.

Assessment of investment attitudes

In July the "Investment attitudes" component is lowered to its value registered in the beginning of the year. Such decline is mainly accounted for by managers' considerably lower propensity to make risk investments in non-core activities. Taken on its own, this fact is not cause for concern inasmuch as it could be interpreted as entrepreneurs becoming more focused on their companies' core business. Such an assumption is also supported by the values for the remaining indicators on the state of investment attitudes. For instance in July two-thirds of businesses experienced a shortage of financial resources. In spite of the fact that taken individually, this share is rather high, we need to place the word "only" before the figure as this is the lowest value since the study was first conducted.

The number of businessmen who shift to exports because they are not satisfied with the sales rates on the domestic market continues to go down. During the second quarter the share of import-oriented businesses dropped to the record-low 27 per cent. It appears businesses' trust in domestic consumption is picking up.

Table 5. Investment attitudes and company strategies, %

	2003		2004		
	July	October	January	April	July
In my current activity I experience deficiency of financial resources	72.8	70.8	72.0	69.3	66.3
I have a business strategy updated regularly	73.5	75.5	76.4	78.4	77.8
If I do not have funds for investment in core activity I will do my best to ensure them	88.1	88.9	88.4	91.2	91.8
I would draw a bank credit in order to invest	59.1	62.1	61.5	65.3	61.8
It is easy to find the employees I need	50.4	51.2	43.8	44.3	42.4
I would introduce new technology if this would enhance the quality of my products, regardless of whether this would have an impact on my profit	82.4	81.2	77.7	80.9	80.5

At the same time the problem with the quality of the workforce continues to deepen and without doubt has a significant impact on the value of the "Investment attitudes" component. According to July figures, only 42% of respondents said they could easily find the workers and employees they needed. By comparison, in July 2002, 60 per cent of entrepreneurs in

Bulgaria shared the latter opinion. The trend registered by the Estat surveys outlines the symptoms of a crisis in the field of human resources. The cause is probably rooted in the migration processes, the quality of professional training and education and the company personnel policies.

The bank lending boom that registered a two-year peak in April seems to be subsiding. However, such a decline is accompanied by a growing confidence in the banking system. 19 per cent fully agree with the statement that lending institutions are reliable and stable while as few as 3% of respondents share the exactly opposite opinion.

Assessment of the business environment

The value of this **Estat Index component is 18.72**, this being its highest level as compared to all previous 11 studies. For the first time Bulgarian business people's attitude to the aspects of business environment crosses over from the negative to the neutral section of the ranking scale.

Although being critical of the government is a business trait everywhere around the world and negativism to those in power is a typical element of Bulgarians' national character, a certain degree of "ice-breaking" between entrepreneurs and the government authorities is clearly discernible. This conclusion is given additional prominence in view of the fact that the current government's term of office is nearing its end and the level of confidence it enjoys should have shrunk to a minimum.

The proposition that the tax system is fair and the legislative framework creates equal conditions for all players is beginning to gain ground. 60 per cent consider the patent tax affordable, while one third do not find it difficult to pay their profit tax. Both values register a record-high for the entire period since the start of 2000.

Just 18 per cent of respondents fully disagree with the statement that there is a high probability for a business dispute to be resolved fairly if it were brought before a court of law.

Gradually businesses are becoming more tolerant to administration, government policy, the letter and spirit of the law and its enforcement. One fifth of entrepreneurs agree with the statement that the government promotes business development. Just one year ago only 8 per cent of company managers shared the same opinion.

The only business environment indicator that does not register a positive development is the attitude to tender and bidding procedures. Only 10 per cent of managers fully or partly agree to the statement that procedures under the Public Procurement Act are transparent and fair. If no fast progress is achieved in this field, its current condition will certainly clash with

entrepreneurs' desire for equal treatment and fairness and will directly deteriorate the business climate.

Table 6. Business environment – Taxation and Legal framework, %

	2003		2004		
	July	October	January	April	July
The patent tax is unaffordable to companies	55.2	51.7	41.5	40.8	40.6
Tax rates force companies to conceal incomes	77.3	79.5	72.6	67.3	68.9
Profit tax is affordable to businesses	26.6	23.2	29.1	32.2	34.3
The tax system creates equal conditions for all companies in the country	15.8	13.7	12.7	20.6	21.1
Social and health insurance contributions are a major burden to businesses	72.7	69.8	72.5	71.8	68.6
The legal framework creates equal conditions for all players	13.9	14.4	14.9	18.9	19.1
Administrative barriers are a major problem for businesses	77.9	80.3	73.0	79.9	76.8
Aligning the Bulgarian legislation to the EU acquis will improve the business environment in Bulgaria	54.4	59.1	51.2	53.2	50.8

Table 7. Business environment – administration, government policy, %

	2003		2004		
	July	October	January	April	July
Most businessmen would pay additional money to avoid difficulties with the administration	82.9	84.2	77.5	80.1	72.5
The practical implementation of the legal framework is difficult	77.9	73.9	76.1	72.5	66.3
The banking system is stable and reliable	40.6	49.8	52.7	56.3	61.9
The government promotes business development	8.8	11.2	10.9	13.5	19.5
Procedures under the Public Procurement Act are transparent and fair	10.2	8.6	6.9	6.5	10.2

A number of positive developments took place in the field of enterprise policy and business environment:

- The amendments to the SME Act were adopted and the first steps for the establishment of an Executive Agency for SME Promotion /EASMEP/ were taken.
- Measures aimed to improve the efficient functioning of markets are improving.
- The PA is successfully implementing its privatization program for the year.
- The government continues its efforts to ease the regulatory regimes for businesses.
- A new corporate income tax cut and accelerated depreciation rates are in the pipeline.
- The government approved employers associations' proposal to remove company registration from the court's jurisdiction.
- A new Public Procurement Act aligned with the acquis was adopted. The Public Procurement Agency was established.

Nonetheless, many issues still remain to be addressed:

- The resources needed for EASMEP are still inadequate.
- No measures have been taken to encourage Bulgarian enterprises' investment in internationally recognized product quality standards although the latter are necessary for improving the Bulgarian businesses' competitiveness.
- Although it would have solved the problem of access to financing for risk projects by innovative enterprises, the issue of encouraging risk investments in SME was been regulated.
- In spite of the progress achieved, the business start-up process in Bulgaria is still far removed from EU good practices.
- A number of regulatory regimes create substantial barriers to businesses: getting planning permission; having a construction project accepted; trade permits etc.

Entrepreneurship and SME Promotion

Following the adoption of the **Act on Amendments to the SME Act** in July, the establishment of the **new Executive Agency for SME Promotion (EASMEP)** was eagerly expected. EASMEP was meant to unite the former ASME and the Executive Agency for Trade Promotion.⁹ With the promulgation of its Structural Regulation (SR) the new EASMEP was officially established in September. The new Structural Regulation foresees an increase in the number of the Agency's regional units to 28, which will result in improved services for local businesses. Unfortunately,

no adequate resources have been provided for these regional units. According to plans, as few as 39 employees will be hired to staff all 28 EASMEP administration regional units, which means an average of less than 2 employees for each region. In view of the great responsibilities stipulated for each regional office, it is difficult to expect that businesses will be very much satisfied with the quality of services the new Agency provides. Such quality would require for the existing local offices of non-governmental business organizations to take over the functions of territorial EASMEP divisions following the principles of public-private partnership. That would be in sync with Bulgarian small and medium-sized enterprises' propensity to put their trust mostly in privately provided public services because of their more adequate response to entrepreneurs' needs for fast and high-quality servicing. That would be a better solution from the point of view of the efficiency of services provided – it is normal for each official servicing businesses to be directly dealing with no more than 50-100 enterprises, following the “good practice” in Ireland for example, and perform his/her functions specially for them. Nevertheless, the SME Act provides for an option allowing the EASMEP Executive Director to authorize persons to represent the Agency. This means that mechanisms to delegate certain powers for the private provision of public services for SME, foreseen as EASMEP responsibilities, are not excluded.

The new Structural Regulations (SR) provides for the Agency to have several Directorates: 1) “Financial and Administrative Services”, with one of its major functions being to provide analysis on the impact of statutory acts in the field of SMEs; 2) “Information Servicing and Regional Coordination” Directorate General, whose staff will include regional EASMEP employees; 3) “Technological Development and Innovation”, in charge of organizing activities to implement measures under the Ministry of Economy's Innovation Policy, and 4) “Competitiveness and Entrepreneurial Skills”, in charge of managing the implementation of the National Strategy for SME Promotion.

EASMEP is expected to become fully operational at the end of October 2004. It should be noted that positive changes in government enterprise policy are rather slow in taking place. An entire year elapsed from the time of submitting the Bill on Amendments to the SME Act in November 2003, which specified a number of positive changes, to the actual enforcement of these measures; in the course of that year entrepreneurs' assessment of the institutional framework for SME in Bulgaria changed in a negative direction¹⁰ Another possible threat to the actual implementation of changes stipulated in the law should also be noted. There is less than a year to run before the next general elections, while a certain administrative lag - which will very probably take more than one year - is needed for the mechanisms provided under the law to be enforced. Therefore it is possible that even before the proposals on which the ME has been working since July 2003 could begin to yield results,

⁹ For comments please refer to “The Bulgarian Economy in the Fourth Quarter of 2003”, Center for Economic Development, March 2004.

¹⁰ See OECD. Bulgaria Enterprise Policy Performance Assessment 2004. The Report will be published in October both in Bulgarian and in English. The study was carried out in March-April 2004 and did not register the businesses' improved attitude to state governance registered as part of the latest business environment study carried out by the ESTAT Agency. For more detailed information please refer to the “Business Climate” Section.

these would be swept away by the possible change in Bulgarian enterprise policy following the general elections.

The slow adoption of new policy measures applies not only to the SME Act amendments. **The SME Investments Promotion Act** was – yet again- not finalized. Since May 2003, when the Bill was passed by the parliamentary Economic Commission - and to this day - it was only passed by the Parliament at first reading. This law, which would undoubtedly have a positive impact on innovative SMEs in Bulgaria, has been “on ice” since February 2004.

During the review period the concept of the **planned Economic Development Act** was further elaborated. It foresees the integration of SME-targeted incentives into Bulgaria’s regional policy and state aid policy. It would be useful to Bulgarian SMEs if the law covered both the framework in which national and regional economic development plans will be drafted and the methods for systematic coordination of measures in enterprise policy with the remaining economic policy measures in Bulgaria. Moreover, because this law – if it is ever passed at all, bearing in mind the limited time the current Parliament has – will continue to be in force following the country’s EU accession, it is necessary for the measures it sets out to be aligned with enterprise policy measures valid for the enlarged EU.

The discussed option of private-public partnerships in the field of public services provision to SMEs, which the newly passed AASMEA foresees, would be unrealistic without addressing the issue of **representativeness criteria for branch and business organizations**. Following more than a year of public discussions on these issues held at the Parliamentary Economic Commission, currently a **Bill on Branch Associations** is being discussed which is expected to solve the problem of representativeness criteria.

Investment Promotion

The policy of attracting more investments into the economy by both local and foreign companies continues to gain pace. The MoE announced a competition to select an Investment Consultant for Bulgaria that would be in charge of analyzing the international investment environment and opportunities to attract more foreign investment into the country. This is a positive development in this section of enterprise policy after the final adoption of the Investment Promotion Act which created quite a stir of interest in the investor community.

The new Investment Promotion Act came into force following its promulgation in the Official Gazette in early August. Even before it was enacted, over 10 applications for individual servicing of projects worth over BGN 50 m were filed with the Invest Bulgaria Agency (IBA, former BFIA). Pursuant to the new law, IBA is responsible for providing institutional support to major Bulgarian and foreign investors. To this end, investors

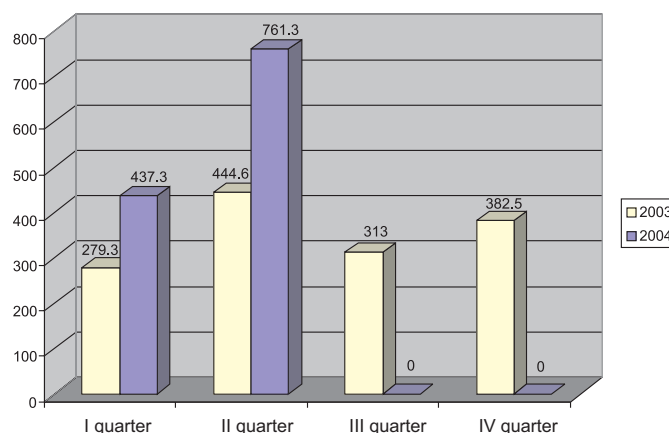
will be certified in three classes based on which the degree of alleviation of administrative services will be determined; for the highest investor class the state will also provide the construction of infrastructure reaching the site. The funds for the construction of such infrastructure will be disbursed by IBA itself. Between BGN 50 and 100 m are expected to be earmarked in the 2005 budget for this purpose. The act’s Implementing Regulations introduce a requirement for investors to provide bank guarantees for the state aid granted for the construction of infrastructure.

The new law features some novel traits - it puts an equal sign between the privileges of Bulgarian and foreign investors; it provides full support to entrepreneurs who invest substantial amounts in the country’s economy; it involves municipalities in providing services to investors. When assessing individual projects, apart from the value of investment, other factors will be taken into account: the number of new jobs it generates, the opportunity to use local subcontractors and the technological level of the planned production. Prospective investors will have to submit to IBA an operational plan stipulating the size of investment, the number of planned new jobs, the necessary facilities and equipment, the expected revenues and expenditures and sources of financing.

With the promulgation of the law and the fact that the country was given an investment rating¹¹ the investment activity of key strategic investors has been visibly invigorated. The time needed for their administrative servicing is expected to be cut by about one third after the Agency takes over the provision of the entire investment documentation required.

Only for the first half of the year 2004, **foreign investment** in Bulgaria exceeded USD 1 b in absolute value. This can be seen from the figure below:

Figure 6. Foreign direct investment (by quarters), 2003-2004 (USD m.)



Source: BNB and MoE <http://www.mi.government.bg/ind/invest.html>

¹¹ At the end of June 2004 Standard & Poor's (S&P) promoted to an investment class the foreign currency sovereign ratings of the Republic of Bulgaria to BBB-/A3 and the local currency sovereign ratings to BBB-/A3 from BBB-/A3.

In view of the fact that the Investment Promotion Act was not in force during the studied period illustrated in the above figure, it could be expected that the considerable increase in foreign investments as compared to 2003 (by over 165 per cent) will continue. Only for the first half of 2004 (the period before the incentive measures were introduced) investment reached USD 1 198.6 m in absolute value, which for the time being confirms the forecast that the size of foreign investment in the country's economy will exceed USD 2 b for 2004. It is reasonable to expect that the effect of investment incentives will be consumed by the economy in real terms as late as next year, when investment projects planned after the introduction of investment incentives will be actually launched.

With Bulgaria's new investment rating awarded by a few rating agencies and the country's forthcoming EU membership, an increasing number of investors who have focused on new EU Member States will step up their activity in Bulgaria. With the now feasible perspective for tax rates in the country to reach their lowest-ever value in 2006¹², the tax policy competition with new EU members and the improved administrative service in Bulgaria will reflect in investors' projections and will probably give Bulgarian economy a better investment vantage point in 2005.

In spite of the positive economic trends, further efforts are needed to attract more investments. Possible steps in this direction could be a constitutional amendment allowing foreign physical and legal persons to purchase land, the setting up of a real estate cadastre, the drafting of an "Investor Map" for each region with publicly available information on plots of land of potential interest to investors. A possible measure to attract more investment into the economy is to transfer profit tax to companies for a given period of time in return for the latter's investment in quality certificates and environmentally friendly production. As few as 1 000 Bulgarian companies are ISO-certified in spite of the growing need to improve the economy's export potential. Thus, along with the diminishing importance of corporate tax for the budget, this could turn out to be an effective measure to step up local companies' investment activity.

Access to Financing

Despite the measures already taken by the government during the first half of the year to cut down the growth rate of business and household lending, the improved access to financing for Bulgarian enterprises persisted. This is evident from the Estat Agency's quarterly surveys which make up the part of the Business Climate index studying the investment attitudes of enterprises. Between July 2003 and July 2004 the percentage of enterprises experiencing a shortage of financial resources has gone down from 73 to 66 per cent while the propensity to

invest in the core business and the willingness to draw a bank loan to satisfy such shortages are going up. This could be given positive assessment in view of the fact that the systemic risk for the banking system is minimized and that lending in Bulgaria (as compared against GDP) has not yet caught up with the levels for newly acceded EU Member States. The growth potential for the competition in banking sector - which would entail further interest rate cuts - has not yet been consumed. On the other hand, the increased investment demand for additional financing could put pressure on the effort to hold interest rates at the current levels. The combined effect of increased competition in the banking sector and the growth in deposits will probably result in further interest rate cuts before the year is out.

After the Encouragement Bank already started the disbursement of a EUR 5 m credit line for Bulgarian exporters, in July the bank agreed with the European Investment Fund another credit guarantee line worth EUR 14 m, with loan collaterals on granted loans starting from 85 per cent of the loan amount. The launch of this mini-guarantee scheme aims to improve access to financing for enterprises with less than 100 employees; applicants are required to prove that the funds will be used for the purchase of fixed tangible and intangible assets.

Discussions on the level of preparedness of Bulgaria's local governments to absorb pre-accession and EU Structural Funds continue to rank high on the agenda. With a little over two years remaining to full EU membership, municipalities are not only facing the possible positive and adverse effects of fiscal decentralization, but also the opportunities opening to them with the instruments provided by structural and regional EU policies. For this purpose, however, municipalities would need a new type of management: project-oriented thinking, high-quality planning of human resource needs and active partnership with local businesses towards the improvement of the local business environment.

Efficiently Functioning Markets

Promoting market efficiency is an important step to the actual restructuring of economy. Along with privatization and emergence of new competition to former state-owned or restructured enterprises in the economy (through a facilitated business start-up procedure), the establishment of efficient anti-trust mechanisms is the next step to strengthening the smooth operation of Bulgarian market economy.

In 1998, the new Competition Protection Act came into force in Bulgaria and, following its amendment of 2002 which constituted the Commission on Protection of Competition as an independent body supervising the disbursement of state aid to certain enterprises, another step has now been taken towards turning the CPC into a body that efficiently protects competitive practices in the economy. With the adoption of the Implementing Regulations to the State Aid Act¹³ CPC now controls the

¹² 10 per cent corporate tax rate and even zero rate in case of profit reinvestment.

¹³ OG, iss. 59 of 7.07.2004

allocation of state aid by all government structures, both central and local, to certain enterprises. The Regulations also lay down the country's commitments under "Competition Policy", one of the last Chapters closed in the EU negotiation process in June this year. The Regulations stipulate the conditions for state support to be admissible in any form (subsidy, state guarantee, participation of government bodies in joint ventures, preferential tax treatment, extension of liabilities to the treasury and NII) irrespective of whether the beneficiary of state aid is state-owned or private. The provision of state aid according to the Regulations will be recorded in a special register on the basis of which the Finance Minister will draft an annual report and will forward it for approval by the Parliament and the European Commission. The Commission's control on the activity of the local anti-trust body guarantees the subsequent improvement of our economy's competitive environment.

As regards enterprises, it is important to note that this piece of implementing legislation declares state aid to be admissible only in specific activities aimed to support SME, promote employment, introduce environmentally friendly production, create incentives for research and development and provide support to regional development. The field of application of measures provided for in the Regulations excludes the areas of agriculture, fisheries and defense industry which are subject to specific sector regulations.

The informal practices during the transition period of providing state aid to certain enterprises or sectors in the form of "soft" budget constraints played a major role in pulling back the country's structural reform. These practices artificially channel or restrain resources to low-productivity operations, which hampers the increase of added value in the economy - and therefore, economic growth in general. With the adoption of the Regulations, conditions are now in place to introduce the trend which has been at play for European economies for a long time, namely: in Bulgarian economy, like in the EU, any form of direct aid to certain enterprises or sectors will gradually subside as an active enterprise policy measure at the expense of horizontal measures supporting the business environment as a whole.

Trade Policy

With the amendments voted by the Parliament to the Export Insurance Act, the Bulgarian Export Insurance Agency (BEIA) will be authorized, starting from 2005, to issue insurance policies covering commercial risk on export transaction payments of up to BGN 100 m. An analysis of the Agency's activity shows that the claims BEIA pays out represent a very small portion of the insurance amounts. This gave the legislator grounds to increase the Agency's insurance capacity without changing the present amount of subsidy which is BGN 10 m. The adopted amendments give more power to the agency and ease the procedure of issuing export insurance policies. An increase in export insurance is one of government's proposals as part of a

package of specific measures to improve the country's balance of payments.

Preparation for the Single European Market

The accession of five CEFTA countries to the EU as of 1 May 2004 necessitated the signing of new agreements covering several different issues. The government has already approved the arrangements and following their promulgation in the EU Official Journal, they will enter into force. Implementation will start by 1 January 2005 at the latest. For example from the beginning of 2005 Bulgarian companies will be allowed a duty-free export of unlimited quantities of fresh and processed vegetables, fruit, jam and also tobacco, sunflower oil and preserved fruit. The duty-free quotas for export from Bulgaria of cheese, wheat, live animals, wine, finished foodstuffs, sausages, and rice have been increased. Minimal import prices for berries are also going down; this applies also to the quota of 2500 t of cucumbers to be processed, while for another 3000 tons of cucumbers the reference price will be reduced in the course of the next three years by 10, 20 and 30 per cent respectively. In its own turn, Bulgaria will also eliminate duty tax for EU countries for powdered milk and animal feed and provides quotas at zero duty tax for veal and rice. The quotas for frozen and preserved vegetables, sausages, apples, apricots, maize are increased.

We discussed the certification issue earlier on. With the moment of EU accession approaching, an increasing number of companies will turn to certification for the purpose of bringing production in line with EU standards. Certification does not guarantee businesses' competitiveness and does not reserve a special place for them on the European market - but without it, it would be hard to work with European partners and defend market positions. For businesses of the food & beverage industry, a license from the European Commission is required to allow exports to EU Member States. Following the latest round of licensing finalized in early September, the number of dairies licensed for EU export reached 28 while the number of slaughter-houses and meat-processing enterprises reached 26, all of them being of industrial capacity.

Alongside the increase in the number of certified companies a reverse parallel process is also observed: that of a growing **euroskepticism** among Bulgarian SME managers. This is also clearly seen from the latest ESTAT Agency study of the business climate. An increasing number of Bulgarian enterprise managers realize that EU membership means more investments in new processes and technology, high quality products and environmentally friendly production that would allow them to preserve or improve their competitive position.

Amendments to the European Directive regulating the recycling of packaging waste in EU Member States requires the re-negotiation of agreements already reached on the collection and use of waste. In 2004 Bulgaria was expected to collect and

use at least 20 per cent of the packaging of goods placed on the market during the year regardless of the type of material. According to amendments in the EU Directive, Member States are obliged to use over 50 per cent of paper, metal, plastics and glass waste.

Privatization

On 30 September 2004, the Privatization Agency reported the sale of 120 companies with over 50 per cent state interest, 54 autonomous parts and 1041 minority blocks of shares in already-privatized enterprises¹⁴. As we set these results against the PA annual plan which foresaw the sale respectively of 119 whole enterprises, 45 autonomous parts and 100 minority blocks of shares, a positive assessment on the performance of planned privatization deals is due - with four more months to go before the end of the year.

The revenue side of the program which foresees a total size of monetary and other financial instruments of BGN 511.4 m has also been achieved. Revenues reported by the PA by end-September are amounting to BGN 649.3 m.

The fact that there are just 120 companies with the state as controlling shareholder still pending privatization and about 300 minority blocks of shares released from restitution claims, calls for the conclusion that the privatization of state property is nearing the end of its 11-year history. At the same time there are some 130 companies on a "no-sale" list. Most of these could be offered up for privatization and develop considerably better if run by private investors.

A proposal to shed this "banning" list is contained in the Bill on Amendments to the Privatization and Post-Privatization Control Act adopted by the Council of Ministers and submitted to the National Assembly on 10 May 2004. Unfortunately, the Parliament seems not to appreciate the government's efforts to clearly define and differentiate responsibilities as part of the structural reform. Amendments to the law provide for political responsibility for the privatization process to be assumed by the Council of Ministers while abolishing the Parliament's powers to adopt privatization strategies. All decisions for the sale of companies with state interest and the adoption of strategies for their sale - according to the Bill - will be taken by the Council of Ministers only.

At the onset of the autumn National Assembly session there are still no signs that parliamentary political forces would agree to the proposed positive changes.

Due to the expiry of the deadline for participation in the privatization process with investment vouchers - 30 June 2004, and the remaining large quantity of unused financial

instruments, the Parliament urgently voted on a procedure to extend the deadline for investment voucher validity to 30 June 2005.

The analysis of Bulgarian economy's current condition drafted by the Board of directors of the International Monetary Fund appreciates the importance of the privatization process for our country's overall economic development. IMF recommendations include both an assessment of the delayed privatization process for state-owned monopolies and deadlines to finalize the procedures for the sale of "Bulgartabac Holding" AD companies and electricity distribution companies by end-2004.

Energy is one of the sectors of Bulgarian economy in which privatization started latest. As of today, most small HPPs, several mines, repair companies and heat supply companies have been privatized. The Privatization Agency is offering 31 companies for sale this year. The remaining HPPs, district heating companies, mines and TPPs are prepared for privatization. Sales are carried out in line with the MEER and Privatization Agency Report approved by the Council of Ministers on 30 April 2004.

On 15 July, 2004, the PA selected Credit Suisse First Boston (Europe) Ltd as consultant for the privatization of "TPP-Bobovdol" EAD, "TPP - Varna" EAD and "District Heating /Toplofikatsia/- Ruse" EAD. The Bank was selected following a competitive procedure in which 4 other international banks - ABN AMRO BANK, Amsterdam, Lazard Freres Banque, Paris, Citigroup Global Markets Ltd, London, and Dresdner Kleinwort Wasserstein Ltd, London - took part. The Agency's Supervisory Board approved the draft agreement on 11 August 2004. The consultants' role will be to prepare the sale and carry out marketing activities for the successful privatization of companies within 12 months.

On 17 July 2002, the National Assembly approved the Strategy for the Restructuring and Development of the Energy Sector. The better part of implementing legislation was prepared and adopted within short deadlines thus giving investors a sense of security. Unlike the relatively low level of interest to companies offered for privatization in other Eastern European countries, privatization offers for Bulgarian electricity distribution companies were a pleasant surprise to experts. The seven companies were grouped into three pools: "West" pool, where "EDC - Sofia", "EDC - Sofia-Region" and "EDC - Pleven" are offered for sale; "Southeast" pool consisting of "EDC - Stara Zagora" and "EDC - Plovdiv" and "Northeast" pool with "EDC - Varna" and "EDC - Gorna Oryahovitsa".

On 15 July 2004, the Council of Ministers decided on the winning bidders for the sale of the 7 electricity distribution companies: for the "West Bulgaria" package the winner was CEZ A.S., Czech Republic, with an offered price of EUR 281.5 m; for "Southeastern Bulgaria" the winner was EVN AG, Austria,

¹⁴ Source: www.priv.government.bg

with an offered price of EUR 271 m; for the "Northeast Bulgaria" package the winner was E.ON Energie AG, Germany, with a price of EUR 140.7 m. **The total amount of offered prices runs at EUR 693.2 m.**

On 9 September 2004, The PA declared the successful finalization of negotiations with E.ON ENERGIE AG, Germany, selected buyer of 67 per cent of the capital on "Electricity Distribution /Elektrozpredelenie/ – Varna" EAD and 67 per cent of the capital of "Electricity Distribution /Elektrozpredelenie/ – Gorna Oryahovitsa" EAD combined in the "Northeastern Bulgaria" package. The price of the deal is EUR 140.7 m.

On 14 September 2004, the Draft Agreement for the sale of 67 per cent of the capital of "Elektrozpredelenie Stolichno" EAD /Electricity Distribution - Capital City/, 67 per cent of the capital of "Elektrozpredelenie – Sofia-Oblast" EAD /Electricity Distribution - Sofia Region/ and 67 per cent of the capital of "Elektrozpredelenie – Pleven" EAD /Electricity Distribution - Pleven/, combined in the "West Bulgaria" package. The Buyer CEZ A.S., Czech Republic, offered a price of EUR 281.5 m.

On 28 September 2004, negotiations between the PA and EVN AG, Austria, for the sale of 67% of the capital of "Elektrozpredelenie – Plovdiv" EAD and 67% of the capital of "Elektrozpredelenie – Stara Zagora" EAD, Stara Zagora, combined in the "Southeastern Bulgaria" package, were successfully finalized with the bilateral signing of the privatization Agreement. The Draft Agreements approved by the PA Supervisory Board are to be submitted for approval by the Council of Ministers.

Reforms in the energy sector are also related to the granting of concessions. According to the Energy Minister's report on the performance of concession agreements for energy resources during 2003, the 19 Concession Agreements for coal mining and oil and natural gas extraction brought concession fees in the amount of BGN 641 thousand to the state budget. For the same period concessionaires invested in their respective sites over BGN 1.5 m. These are the Beli Breg, Chukurovo, Lev and the Katrishte deposit and Bela voda from the Pernik Coal Basin deposit.

The government is now well in its final year in office - and yet strategies for the privatization of Navigation Maritime Bulgare, Bulgarian River Shipping and the Bulgaria Air Airlines have not yet been considered and approved by the National Assembly.

The state's withdrawal from the "maritime economy" sector is exceedingly slow. Agency services as well as brokerage and shipment activities, towing, ship Chandler services and ship repair activities have been privatized. Thus the privatization in the field of the services has been finalized. The sector's performance is however defined by the privatization and concessioning of structurally significant enterprises. No concession has yet

been granted on ports, piers and terminals. The deteriorated condition of the sector requires more generous funding by the government. Virtually, the infrastructure and fixed assets remain state-owned without the owner showing any concern for their development. Moreover, the state does not allow private ownership and access to investments. The additional adverse effect of delayed reforms is the draining of qualified staff, low productivity and its impact on other sectors of the economy.

PriceWaterhouse Coopers were selected as consultants to the sale of NMB and BRS in September 2002. The delay in the two procedures resulted in the need to update the entire documentation for the sale of the companies.

On 18 August, the government adopted the new strategy for the privatization of 100% of "Bulgaria Air". A two-stage competition to select the buyer is foreseen. Only large airline companies with annual revenue exceeding EUR 100 m for each of the last 3 years will be eligible to participate. If the applicants who were granted a registration certificate during the first stage of the competition are less than 4 in number, then financial investors and consortiums will also be eligible to participate. Prospective bidders need to prove that they are managing financial assets in an amount exceeding BGN 200 m. The strategy also contains additional requirements to bidding companies. They must be either from EU Member States or from Bulgaria. Other investors will be required to establish a subsidiary in Bulgaria.

The several months remaining before end of this government's term of office outline two conflicting trends in development of the privatization process. On the one hand, we have the fruitful work of the Privatization Agency, which succeeded in implementing its Program for the entire 2004 within the first 8 months of the year. The sale of minority blocks of shares of already privatized companies on the Stock Exchange is a process as part of which, due to PA experts' efforts, the assets of another 300 companies will be consolidated before the end of the government's term of office. Deals on the sale of majority state shares in 122 state-owned companies are also expected to be finalized. The biggest privatization deal in the history of Bulgarian privatization is also drawing to a close – the sale of the 7 EDC for a total amount of EUR 693.2 m.

By end-2004 the holding's Supervisory Board will try to sell the first "Bulgartabac Holding" AD companies.

Expectations on the progress of privatization deals in the transport industry are quite at the other end of the scale. The falling-behind in that area is so serious that before the end of its term of office the National Assembly, the Council of Ministers and the Ministry of Transport will probably not manage to adopt the privatization strategies, announce the privatization procedures, select on buyers, secure approval by all institutions and strike the deals.

Regulatory Regimes

The government continues its efforts to alleviate regulatory regimes and improve the business environment. In June and July the Ministry of Economy, with assistance from the Center for Economic Development, implemented a project aiming to review and analyze regimes administered at the municipal and central level. "Vitosha Research" carried out a survey of businesses' attitudes and opinion on the state of regulatory regimes. As a result 6 regimes were identified that seem to cause the gravest problems for businesses and affect the largest group of entrepreneurs. In experts' opinions, efforts to streamline regimes must be precisely targeted at these regimes that appear to be most problematic and causing the greatest difficulties. Thus, businesses' demands and actual needs can be met to the highest degree; it would also allow for measures to be taken which will actually result in tangible improvement of the regulatory environment.

Such an approach could result in achieving a consensus on the priorities in the regulatory reform process and could be considered as a form of dialogue between the business community and the government on administrative obstacles that must be overcome as a matter of urgency. Also, the idea is to use reasonable proposals formulated both by individual entrepreneurs and branch associations; the latter are, in most cases, very well aware of the problems "on the ground" and are in a position to come up with adequate proposals to address these issues.

A new aspect in the project is to study the state of regulatory regimes administered at the municipal level. A detailed description of regimes administered at the local level is being presented for the first time and a picture of these regimes is drawn. A few proposals aimed to streamline some of them are also provided.

Legislative changes related to the regulatory environment are currently being prepared. The Economic Commission at the National Assembly is currently discussing amendments to **the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity (ARARACEA)**. These amendments intend a more active involvement of the business represented by its branch organizations and delegating controlling authority to these organizations. A number of industries already have branch organizations commanding adequate authority and successfully standing for their members' interests. Currently, however, no mechanism is in place to delegate authority to these organizations. In the opinion of the proposals' authors the establishment of such a mechanism would be taking the reduced administrative control on business activity one step further and expanding economic freedom. Another effect that could be achieved through that mechanism is to establish good self-regulation and self-control practices for businesses.

The bill foresees an option to delegate administrative control within the meaning of Art. 1, Para. 4 of ARARACEA related to the enforcement of the registration regime for economic activity. In order to be granted such authority the law stipulates that the branch organization must be nationally represented in terms of the coverage of companies engaged in the respective economic activity.

It is expected that amendments to ARARACEA will result in stepping up the dialogue and improved trust between the private sector and the government. Businesses' self-control will also be improved, which brings its own benefits – greater flexibility, better professional awareness of the controlled activity, lower cost and respectively saving administrative and financial resources to be otherwise spent by the public sector.

Regulation of Public Procurement

The new Public Procurement Act came into force on 1 October. The government also adopted the **Implementing Regulations to the Public Procurement Act** promulgated in late September. The Regulations govern the implementation of the Public Procurement Act, including circumstances to be recorded in the Public Procurement Register, as well as the types of supplies to be delivered on the basis of a contracting procedure without notice. Supplies are listed as an Appendix to the Regulations with the intention to limit the types of commodities to be traded on the exchange and avoid the current practice of procurement of non-traditional commodities through the commodity exchange. The list covers 25 goods and it is only for these that a procurement method involving a Commodity Exchange transaction can be applied.

Sample documents were also published. These are required in the organization of procedures for the award and execution of public procurement contracts. These documents are 10 in number and involve all stages of the procedure to award, execute and finalize a public procurement contract.

It should be noted that the implementing legislation related to the Public Procurement Act was developed and adopted within the initial deadline. This fact undoubtedly deserves to be positively appreciated as it provides greater clarity and transparency in the law implementation.

In September the government also adopted the **Ordinance on the Award of Small Public Procurement Contracts** under the Public Procurement Act (PPA). This document lays down the terms and conditions for the award of public procurement below the thresholds established in the law. The procedures for the award of "small" public procurement contracts stipulated in the Ordinance are as follows: open procedure, restricted procedure, negotiated procedure with prior publication of a contract notice, direct purchase based on price quotations and open design contest. A novel aspect is the public tender

applicable only to the procurement of supplies. This method is applied where the public procurement object is defined in terms of quality, quantity and value with tenderers only given the option to offer their price. The contracting authority sets the maximum price and the bidder offering the lowest price is awarded the contract.

The Ordinance introduces two new value thresholds below the thresholds stipulated in the PPA. Below the first threshold contracting authorities do not hold a procedure and document the expenses with a regular invoice. Between the first and second threshold contracting authorities also hold no procedure but request three price quotations. Above the second threshold the procedures established in the Ordinance are applied.

Contracting authorities for public procurement are divided into two groups – classic and sector-based. The first group includes central and local government bodies and the second one includes companies in transport, water supply, energy and postal services. According to the type of contracting authority the thresholds were established below which no public procurement procedure should be conducted. For example in the case of classic contracting authorities in construction the threshold is BGN 45 thousand for a location in Bulgaria and BGN 90 thousand outside the country. For supplies the threshold is BGN 15 thousand for the country and BGN 30 thousand abroad; for services – respectively under BGN 10 thousand for the country and BGN 20 thousand abroad; for design contest – below BGN 3 thousand.

In August, the government adopted **the Ordinance on the Terms and Procedures for the Award of Special Public Procurement Contracts**. It provides for suppliers to be selected following either a general or special procedure and regulates transactions that fall out of the scope of the Public Procurement Act. The Ordinance governs contracts related to national security.

The general procedure for selection of the supplier for a special public procurement contract foresees for the award of the contract following direct negotiations with the tenderers or through a document review. The specific procedure is selected by the contracting authority. In a general procedure the price is fundamental for the choice of supplier. It is obligatory, however, that two conditions be met – one, that the procurement contract is for the delivery of supplies and services for which no access to classified information is required; and, two, that the value of the contract is below BGN 30 thousand.

The Ordinance also stipulates the procedure for concluding **off-set agreements** and the cases when these are admissible. Offset agreements are contracts under which the contractor for a public procurement contract is bound by obligation to the contracting authority to make investments, to conclude and execute agreements for the delivery of Bulgarian goods

or services or construction by Bulgarian companies, to provide equipment, technology and licensing. In this way contracts will be awarded to suppliers who are prepared to purchase equipment from Bulgarian enterprises or to invest in the country.

The Ordinance prescribes in detail the procedure to award a public procurement contract under an offset agreement. Such a procedure is held in all cases where prospective contractors are only foreign persons and the value of the deal is above BGN 10 m.

The award of a public procurement contract under an offset agreement goes through several stages: first the key parameters of the planned procurement contract are laid down; then an analysis of the offset opportunities is made, followed by opening the procedure itself. A special commission is established to review tenderers' offers. The Ordinance which will become effective as of 1 October 2004 established clear rules for public procurement in the area of national security.

In early September the government adopted **the Regulation and Statutes of the Court of Arbitration at the Public Procurement Agency** in charge of providing out-of-court settling of disputes on public procurement. The court was set up in compliance with the provisions of Art. 20 of the Public Procurement Act.

The Court of Arbitration will consider and settle disputes that are explicitly specified to be within its jurisdiction through an arbitration agreement to which the contracting authority and all tenderers in a public procurement procedure are parties. The Agreement must be made in writing. The court will consider and decide on disputes brought before it through its decision-making body which may consist of one or three arbitrators. The parties may appoint as arbitrator any person who is a major Bulgarian citizen with no criminal record and has no less than 5 years of experience in the legal profession. Cases will be heard *in camera*. With the approval of the decision-making body and the consent of parties to the case persons unrelated to the case may be present at the sitting.

The adopted Statutes specify that the Court of Arbitration will consist of a presiding judge, arbitrators and Secretariat. The presiding judge is assigned by the Council of Ministers for a period of 5 years without restriction as to the number of his/her terms of office. Any person meeting the requirements of the Public Procurement Act can be an arbitrator for cases brought before the Court of Arbitration. Arbitrators must be independent and unbiased in performing their functions, make decisions according to their best judgment based on the objective consideration of all circumstances under the case, guided by the law and their own conscience.

A Secretariat will also be established at the Court; its staff will be appointed by the Public Procurement Agency. Its key task will be the technical organization and assistance in the processing of arbitration cases. The fees to be paid by disputing parties for settling disputes at the Court of Arbitration will be between BGN 500 and 850. If the case is terminated before the incorporation of the decision-making body, the petitioner will be refunded 75 per cent of the arbitration fee. The regulation and statutes of the Court of Arbitration will enter into force on 1 October 2004. Previous experience from the BCCI Court of Arbitration and the Bulgarian Industrial Association was used in the process of their elaboration.

Fight against Corruption

The results of a **study on tax administration carried out by Coalition 2000 and Vitosha Research** were published in late June. The main purpose of the study was to assess the attitude of tax administration employees to reforms in this area and to identify the major problems and misappropriations in the tax system; another objective was to establish employees' views on the successful solution of these problems. The results will be used in setting the priorities in fighting corruption in this important area.

Some of the major conclusions in the report include:

- The major barriers in the field of tax administration are: the inadequate remuneration of its employees; the omissions and ambiguous texts in legislation; the frequent amendments to legislation governing the activity of tax employees; obsolete facilities and poor workplace conditions; red tape involving complicated and cumbersome procedures.
- Taken as a whole, tax employees give their own performance a positive appraisal – in their opinion no valid allegations on the lack of professionalism and professional ethics or poor service to citizens can be directed to them.
- Most changes in tax policy are positively appreciated: this concerns the lower tax rates under the Taxation of Physical Persons Income Act, the introduction of VAT-accounts, the setting up of a Tax Police under the Minister of Finance, the creation of a single revenue administration etc.
- According to respondents, the most frequent cases of fraud occur in connection with the value added tax and businesses registered under the VAT Act are most prone to concealing income.
- The view that citizens offering bribes to employees should be punished with the same severity as bribe-taking tax employees seems to be prevailing. Most respondents say they would take action to sanction corruption practices if they witnessed such practices¹⁵.

The latest Business Climate study of the **ESTAT Agency for Social and Marketing Surveys**¹⁶ registers a certain decline in

businesses' corruption tolerance. Thus, if in July this year 73 per cent of surveyed entrepreneurs agreed to the statement that "Most businessmen would pay additional money to avoid difficulties with the administration", we have to recall that one year ago the same percentage was 83.

However, corruption issues again occupied a central position in the **European Commission's Regular Report on the Progress of Bulgaria** to EU accession published in early October. According to the report, corruption remains a serious problem in Bulgaria while the government's approach does not focus on corrupt senior officials and politicians. The reasons cited include the poor efficiency of the judiciary branch, the low transparency in terms of disclosure of personal interest by elected politicians and the financing of political parties and pre-election campaigns.

In connection with the **unveiling of "VAT -draining" schemes** widely publicized in late September, the issue of corruption in some public administration sectors made it to the top of the agenda once again. Mechanisms to "drain" VAT are diverse and according to figures supplied by the General Tax Directorate the loss of budget revenues over the past five years amounted to BGN 2.5 b, with the assumption of another undisclosed BGN 4 b for the same period. It is assumed that part of these enormous sums of money probably represent direct corruption payments to tax and customs employees, policemen and politicians.

Assessment of the business environment and business opportunities

In early September, the **World Bank's Report "Doing Business in 2005"** was published. Bulgaria was ranked 50th among 145 studied countries. According to the report, starting a new business in the country requires 32 days and 11 procedures with costs equaling 10.3 per cent of the income per capita. According to this indicator Bulgaria outstrips Germany, Greece and Hungary. Turkey made the most significant progress by cutting down on the business start-up time from 38 to 9 days. OECD countries require an average of 6 procedures, 27 days and the cost of documentation is 8 per cent of income per capita.

According to the indicator "Days to register property" Bulgaria ranks second in SE Europe after Turkey. The procedure takes 19 days in Bulgaria while for Turkey it takes only 9. In the remaining countries in the region a much longer period of time is necessary – in Romania 170 days, in Serbia and Montenegro – 186, in Poland – over 200 days.

Overall, it would be a safe assumption to say that Bulgaria made good progress in the area of administrative procedures and

¹⁵ Source: <http://www.anticorruption.bg>

¹⁶ For more details please refer to the "Business Climate" Section.

alleviating businesses from red tape; however, further reforms are necessary. The situation is particularly grave in courts and delayed court procedures resulting in the waste of time and funds for businesses.

The report also says that several economies in transition, among which Bulgaria have already introduced tax rates at levels lower than the remaining countries in Europe. Progress has been achieved also with respect to bankruptcy procedures. New EU Member States are particularly active in making reforms – the need to deal successfully with the competitive pressure of market forces in the EU is a strong incentive for them. Slovakia appears to be the best performing among these countries.

Economic Freedom Index

The annual report “Economic Freedom of the World: 2004” published by the Canadian Fraser Institute was published in July. Bulgaria occupies 78th position; last year it ranked 103rd. Moving up 25 positions could be evaluated positively; it means that the economic freedom in the country has improved. The study involves 50 indicators whose values define the level of economic freedom. For most indicators the country gets higher marks or retains previous values. The evaluation of the banking system is particularly positive – the presence of active competition in the banking sector; flexibility on the labor market etc.

The rating given to the state for the judiciary in the country and in particular for indicators such as independence and impartiality of the court still remains low. The rating given for the protection of intellectual property is relatively low. Less favorable as compared to the previous study are index values for hidden import barriers, underdeveloped capital market and difficult access to foreign capital. According to the report, the highest level of economic freedom is registered in Hong Kong, followed by Singapore, New Zealand, Switzerland, the USA and others.

Budget execution as of the end of July 2004

Consolidated budget (covers the national budget and all autonomous budgets – those of local governments, insurance funds, state universities, Bulgarian Academy of Science, Bulgarian National Radio, Bulgarian National Television, Supreme Judicial Council, as well as extra-budgetary funds and accounts on central and local level).

Overall, we witnessed a very good rate of execution of the consolidated fiscal program throughout the first seven months of 2004, with most budget items showing positive performance as compared to the same period of last year. According to data from the Ministry of Finance as of 31 July, 2004 **the surplus on the consolidated fiscal program** increased considerably as compared to the relevant period in 2003 (BGN 651.3 m) and is now in the amount of BGN 976.7 m.

Revenues and aids by the end of July 2004 are in the amount of BGN 8 996.5 m, or 62.3 per cent of the planned total annual amount in the consolidated program. By comparison, in the first seven months of 2003 revenues to the consolidated budget equaled BGN 8 054 m, or 60.3 per cent of the planned annual amount and 57.2 per cent of the generated revenues. Tax revenues and indirect tax revenues in particular made a major contribution to the good execution of the revenue part as a result of the increased domestic market demand. **Expenditures** for the period amount to a total of BGN 8 019.8 m., or 54.6 per cent of the annual amount of expenditures under Budget 2004. By comparison, during the same period of the preceding year these amounted to BGN 7 402.7 m (54.3 per cent as compared to budget estimates and 52.6 per cent of expenditures made during the year). With regard to aggregate budgets, sizeable expenditures are reported in the national budget (particularly in its part for ministries and agencies) and also in the budgets of social insurance funds and municipalities.

According to our estimates, the generated surplus on the consolidated fiscal program as a result mainly of the surplus on tax revenues will exceed the amount of BGN 1 b before the end of the year. This year again, additional revenues will most probably be used to finance some postponed expenditures (incl. 10 per cent of planned expenditure on municipal state-delegated activities) and payments of bonuses and special incentives for public sector employees and pensioners. The generation of unplanned expenditures at the end of the year results in an increased share in GDP of funds re-distributed through the budget above the levels stipulated in the State Budget Act. This means in fact a greater degree of government intervention in the economy and in the distribution of income between economic agents. Moreover, establishing the practice to spend additional funds at year end in favor of individual groups of the population creates a sense of anticipation in these groups for extraordinary income in the future and thus distorts their economic behavior.

National budget (comprising the central budget, budgets of ministries and agencies and the budget of the Audit Office)

A **surplus** in the amount of BGN 778 m is reported in the national budget. Revenues and aids account for BGN 5 912.6 m (65.3 per cent of revenues planned for the year) while expenditures and transfers amount to BGN 5 134.6 m (55.3 per cent of the planned annual amount according to budget estimates for 2004). By comparison, last year these values were respectively BGN 4 985.1 m in revenues and aids (65.1 per cent of the planned amount and 59.1 per cent of reported revenues) and BGN 4 372.7 m in expenditures and transfers (54.5 per cent of the program and 51.1 per cent of the total amount of expenditures and transfers made during the year).

Central budget

The central budget **surplus** is BGN 604.7 m with revenues amounting to BGN 5 094.5 m and expenditures and transfers amounting to BGN 748.1 m and BGN 3 741.7 m, respectively .

Fiscal reserve (covers cash in BGN and foreign currency on all current and term deposits with the BNB and commercial banks of the central budget, the budget funds of ministries and agencies, the National Social Security Institute, the National Health Insurance Fund and their extra-budgetary accounts and funds, as well as other high-liquid low-risk financial assets in foreign currency of the government).

As a result of the operation of advance repayment of debt on Brady bonds (DISCs), the fiscal reserve at the end of July 2004 registered a decrease by BGN 1 062 m as compared to the previous month and amounts to BGN 4 096.5 m, of which deposits in BNB amount to BGN 3 663 m and funds in foreign currency assets are BGN 2 092 m. Table 8 illustrates the fiscal reserve dynamics by July 2004.

Table 8. Indicators of the fiscal reserve (FR) according to the Agreement with IMF (BGN m)

	As at 31 March 2004	As at 30 April 2004	As at 31 May 2004	As at 30 June 2004	As at 31 July 2004
Total amount of FR	4 114.2	4 415.1	4 642.1	5 158.5	4 096.5
FR funds in BNB deposits	3 503.2	3 822.5	4 203.8	4 802.9	3 663.0
FR funds in foreign currency assets	1 986.8	1 975.5	1 912.2	2 199.4	2 092.0

Source: MoF data

The considerable funds accumulated in the fiscal reserve as at the end of July 2004 and the lack of clear legislative regulation on opportunities to apply active management lead to a continuing public debate on this topic over the past months. The concept that the state should transfer to NSSI part of the funds from

the fiscal reserve aggregated or soon to be expected from the privatization was further developed. The concept foresees for funds to be invested by NSSI and, with the generated income from such investment, to improve the insurance institute's funding. For this step to have a real effect, however, these funds should be invested at a higher profitability and higher risk than the options currently provided by the law. Also unresolved remains the issue of the consequences of such a measure: an increase in pension payments and/or a decrease in the size of due contributions. From a more general perspective financing NSSI with funds from the fiscal reserve actually means an increase of the budget share in the insurance system.

Municipal finance

As of 31 July 2004 municipal budgets reported a surplus of BGN 79.7 m with BGN 460.2 m in revenues, BGN 738.3 m in net transfers and BGN 1 118.8 m in expenditures.

Revenue side of the national budget

Tax revenues

Tax revenues to the national budget as at 31 July 2004 amount to BGN 4 755.6 m as compared to BGN 3 732 m during the same period of last year. Execution by the month of August 2004 is 63.5 per cent as compared to the annual revenues planned in the State Budget Act. As at the end of April 2003 the execution of tax revenues to the national budget was 61.2 per cent of the amount planned under the State Budget Act for annual revenues.

VAT accounts for the highest relative share in **tax revenues**—44.4 per cent of total tax revenues as compared to 46 per cent of the total executed over the same period in 2003. Execution of VAT for the first seven months of 2004 is BGN 2 110.4 m (63.3 per cent of planned VAT revenues for the year), against BGN 1 717.1 m at the end of July last year (58.3 per cent of the planned total annual amount). The key reason behind such an increase is the improved VAT revenues from imports as a result of imports growth during the first seven months of 2004 as compared to the same period of last year.

Excise duties and charges on liquid fuels account for a high relative share of revenues – BGN 1 004.2 m or 21.1 per cent of total tax revenues. The tax execution as compared to annual estimates is 57.5 per cent as of the end of July against 55.5 per cent at the end of July 2003. New higher rates on liquid fuels and tobacco products influenced the growth of revenues from excise duties. Another factor determining the size of revenues from excise duties is the increased import of gas oil, heavy oils and automotive petrol as compared to the same period of last year.

The relative share of revenues from **corporate tax** by 31 July 2004 (BGN 609.2 m) is 12.8 per cent of tax revenues against

17.8 per cent for the preceding year (BGN 664.7 m). The lower share of revenues generated from corporate tax in total revenues as compared to 2003 is the result of the changed size of due advance installments because of the lowering of corporate tax rate from 23.5 per cent during 2003 to 19.5 per cent in 2004, as well as taxes paid in excess in the course of the preceding year by companies which because of this make no advance installments during the current year. The tax execution from corporate tax as at the end of July as compared to the annual estimate for 2004 is 71.6 per cent. The good corporate tax execution as compared to budget estimates over the review period can be accounted for by the growth in 2003 taxable profits for some of the large companies in the country.

The share of revenues from **personal income tax (PIT)** by the end of July is 14.6 per cent of the tax revenues against 6.1 per cent for the same period of last year. The execution of PIT on a net basis is BGN 694.9 m or 62.7 per cent as compared to the annual estimate. For the same period of last year collected revenues amounted to BGN 227.2 m or 60.5 per cent of annual estimates. The major reason for the substantial increase of PIT revenues as compared to the same period of last year was the minimum social insurance threshold introduced since 1 January 2003. Increased revenues are also due to proceeds from incomes tax under labor contracts payable for 2003 year, for which the tax was paid in January 2004, as well as the payment of tax liabilities as per the annual tax return for non-labor relationships.

Revenues **from customs duties and charges** amount to BGN 155.3 m or 76 per cent against annual estimates. The increase as compared to the same period of 2003 amounts to BGN 29.2 m.

Non-tax revenues and aids

Non-tax revenues to the national budget at the end of July amount to BGN 1 142.8 m or 73 per cent as compared to annual estimates. A decrease in the amount of BGN 99.9 m is registered as compared to the same period of last year. **Property revenues** (BGN 484.1 m) and revenues from **state fees** (BGN 306.8 m) contributed to the generated non-tax revenues. As at the end of July 2004 a surplus above the planned total annual amount of other non-tax revenues (119.5 per cent of planned) and the BNB contribution (109.5 per cent of budget estimates) is registered.

Taken as a whole, the trend of inaccurate budget revenue estimates persists, thus inhibiting the efficient planning of budget expenditures on annual and quarterly basis. The practice of spending the surplus generated in the course of the year during the last months of the year may lead to the sub-optimal utilization of available resources. The saving of funds generated at the end of the year from the overexecution of budget revenues and using them to compensate a more

considerable decrease of the tax burden over the next year is one of a number of possible solutions.

Expenditure side of the national budget

Expenditures

The highest relative share of 38.9 per cent of total expenditures belongs to **running costs** (BGN 1 311.5 m). These include costs for medicines, fuel and energy, hired services, current repair, as well as defense and security expenditures.

Interest paid for foreign and domestic debt servicing as at the end July amounts to BGN 583 m, of which BGN 121.1 m on domestic loans and BGN 461.9 m on foreign loans. The relative share of expenditures for interest payments during the period accounts for 17.3 per cent of the total budget expenditures (against 19.7 per cent in the first four months of 2003).

The trend for increased **subsidies** both in nominal terms and as a share of total expenditures has persisted - BGN 341.3 m or 67.3 per cent of annual estimates. By comparison subsidies granted by the beginning of August 2003 amounted to BGN 319.7 m or 61.2 per cent of the annual amount planned in the national budget. The dynamics of subsidies granted during the first four months of 2004 leads us to believe that it is possible for funds actually allocated in the course of the year to exceed original budget estimates. This comes in contradiction with intentions announced by the government and written in a number of formal documents (incl. in the Memorandum on Economic and Financial Policy of 6 August 2004).

There has also been an increase in **social and scholarship expenditures** by nearly 12 per cent as compared to the same period of last year - from BGN 298.1 m to BGN 334.4 m. The latter's share in the total expenditures remains relatively constant.

Transfers

Net transfers (the difference between received and allocated national budget transfers) from the national budget to other budgets amount to BGN 1 765.4 m. The national budget has allocated to municipalities BGN 732.7 m or 62.9 per cent of the planned total annual amount. Transfers made from the central budget to the budget of NSSI amount to BGN 605.4 m or 61.2 per cent of the annual estimate. The central budget subsidy to the budget of the judiciary amounts to BGN 90.6 m or 59.6 per cent of the annual amount.

Future directions of fiscal policy

The key aspects of fiscal policy in the short term were set out in the Memorandum on Economic and Financial Policy of 6 August 2004 between the government of the Republic

of Bulgaria and the International Monetary Fund. The economic program for the 2004-2006 period aims to reduce the vulnerability of the foreign and financial sector in order to maintain the microeconomic stability and achieve sustainable growth rates as part of the preparation for EU membership in early 2007. The program heavily relies on fiscal corrections, strict income policy in the public sector, increased bank supervision, measures to cut down on banks' liquidity and also on structural reforms (incl. privatization) in the context of the currently valid Currency Board regime. The Bulgarian government has made a commitment to keep the latter until the country's membership in the Economic and Monetary Union and the adoption of the Euro as official tender at the end of the decade. Due to the limited opportunities to conduct any monetary policy in the conditions of a Currency Board Arrangement and the open capital account, microeconomic policy in the medium-term perspective will mainly rely on the instruments of fiscal policy.

The government program aims to achieve at least a balanced consolidated budget in 2004 by withdrawing the fiscal incentive originally planned for the current year¹⁷. The Memorandum on Economic Policy foresees for fiscal policy to be "slackened" in 2005-2006 only if the credit expansion is restrained and the foreign current account deficit is maintained within acceptable limits. In spite of the costs related to NATO and EU membership and the unfavorable demographic factors impeding the decrease in the state's participation in the re-distribution processes, the government made a commitment to use the increased excise duty rates related to EU accession to cut down on direct taxes and improve the quality of expenditures by reducing subsidies and targeted social expenditure, thus enabling priority spending on investments, activities and financial support. In the event of an unchanged fiscal position, revenues from the privatization and the frugal use of state guarantees would allow the government debt ratio to fall to 37.75 per cent per cent of GDP by end-2006.

Foreign and domestic debt

At the end of July 2004 the **total amount of government and government-guaranteed debt** was BGN 16 089.2 m at BNB's central exchange rates for the Bulgarian lev as of 30 July 2004. As compared to the end of April, a considerable decrease in the total amount of debt is reported by BGN 1 243.6 m. The registered drop in the size of debt is mainly accounted for by the advance repayment of Brady bonds of the DISC type at the end of July. Another factor working in the same direction are the reported exchange rate differences during the review period. At comparable data the debt/GDP ratio has dropped from 45.6 per cent at the end of April 2004 to 42.4 per cent at the end of July.

¹⁷ In the "Financing" Section of Budget 2004 expenditures with a maximum size of BGN 500 m were included, intended for infrastructure projects whose absorption was planned for the second half of the year under the condition of a good budget revenues execution.

As compared to the end of July 2003, the total amount of debt was reduced by BGN 1 377.5 m.

In dollar terms, government and government-guaranteed debt has also decreased by USD 684 m for the period from end-April to end-July 2004 (from USD 10 587.6 m to USD 9 903.6 m according to BNB central exchange rates for the respective dates). This is due to the changed foreign currency structure of the debt as a result of the advance payment of USD-denominated Brady bonds of the DISC type and also to the fluctuations of the Euro exchange rate against the US dollar. As of the end of April 2004 the dollar-denominated debt accounted for 42.2 per cent of the total amount of the government and government-guaranteed debt while at the end of July the dollar-denominated debt had reached 37.5 per cent. As a comparison, the share of Euro-denominated debt increased from 34.5 per cent of the total amount as of the end of April to 37.5 per cent as at the end of July 2004 (BGN debt also registered an increase in the debt structure during the review period – from 9.6 per cent to 10.5 per cent). Thus as at the end of July 2004 a relatively balanced debt structure is achieved in which the debt in EUR and US dollars represent equal weight.

Over the next months the amount of the debt will probably continue to be predetermined by the dynamics of the exchange rate of the Euro against the US dollar and the changes in the foreign currency structure of the debt. At any rate, however, the total debt/GDP ratio will be preserved within the Maastricht limits and will probably keep its trend of progressive decline.

Foreign debt

According to data from the Ministry of Finance, at the end of July the size of foreign debt decreased to EUR 6 950.8 m (against EUR 7 603.1 m at the end of April), the government debt accounting for EUR 6 491.7 m (against EUR 7 152.8 m at the end of April) and government-guaranteed debt amounting to EUR 459.1m (EUR 450.3 m as of 31 April 2004). In dollar terms, however, due mainly to the advance repayment on bonds DISC, for the period from end-April to end-July 2004 the total amount of debt registers a decrease of USD 715.3 m. In BGN terms, the amount of foreign debt decreased by BGN 1 275.8 m. The total amount of foreign debt at the end of July is USD 8 368.1 m or BGN 13 594.6 m recalculated at the BNB rate of BGN against the US dollar as at 30 July 2004.

As a result of the debt management operations substantial changes are observed as compared to the end of April 2004. The Euro-denominated debt is 40.2 per cent (against 36.4 per cent at the end of April) while the debt in USD and other foreign currencies is respectively 42.6 (47.5 per cent as at 30 April 2004) and 17.2 per cent (16.1 per cent at the end of April). The interest structure is also subject to very slight change. The

ratio between floating interest rate debt and fixed interest rate debt is 58.7 per cent to 41.3 per cent. The weighted average residual term of the debt has been lowered by three years to 6 years and 8 months. The largest share is that of debt in other bonds - global and eurobonds (30.8 per cent) and Brady bonds (amounting to 18.9 per cent). The share of debt to the IMF increases slightly, reaching 14.1 per cent. Outstanding liabilities to the World Bank amount to 12.7 per cent, on government-guaranteed borrowings – 6.6 per cent, to the EU - 5 per cent, and to the Paris Club - 2.8 per cent.

On 28 July 2004 the Bulgarian government exercised its right of repayment before maturity of discount Brady bonds (DISCs) issued in compliance with the Agreement with the London Club private creditors of 1994. On that date the entire principal in the amount of USD 679.3 m on discount bonds was repaid. The operation aimed to decrease the nominal size of foreign government debt, reduce the funds needed to service the government debt over the next 20 years, balance the currency and interest structure of the debt and also free-up the amounts maintained as collateral for interest and principal. Due to the proceeds from the freed-up collateral the fiscal reserve funds used for this purpose in net terms were a little below USD 400 m.

There have been several positive effects from the operation. In the first place, an opportunity is created to make considerable savings from the payment of interest until the bonds' maturity date in 2024 which can be channeled to finance other priority expenditures and/or to lower the tax burden. Secondly, the decreased debt/GNP ratio as a result of the operation represents a positive signal to investors and international rating agencies. In addition a more balanced debt structure was achieved with the share of US dollar-denominated debt decreased at the expense of EUR-denominated debt.

Domestic debt

As of 31 July 2004, according to data from the Ministry of Finance, the domestic debt amounts to BGN 2 494.7 m. Compared to end-April 2004, it marked an increase in the total amount of domestic debt by BGN 32.4 m.

Within the structure of domestic debt at end-July 2004 the share of government securities issued for financing the budget deficit accounts for 79.6 per cent (against 79.2 per cent at the end of April 2004) of the total amount of domestic debt. At the end of July the share of debt on government securities issued for financing structural reform amounted to 20.4 per cent (against 20.8 per cent at the end of April) of the total amount of the domestic debt. Table 9 illustrates the dynamics of the total domestic debt structure.

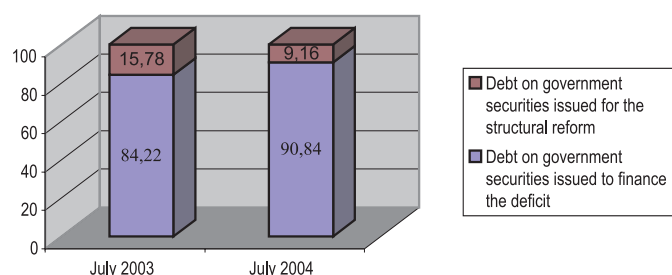
Table 9. Total domestic debt structure (%)

Debt structure	As at 31 July 2003	As at 30 April 2004	As at 31 July 2004
Debt on government securities issued to finance the deficit	73.9	79.2	79.6
Debt on government securities issued for the structural reform	26.1	20.8	20.4

Source: According to MoF data, Government Debt monthly bulletins

Total expenditures on the domestic debt (interest and discounts) as at end-July 2004 amount to BGN 99.9 m (against BGN 96.4 m for the first seven months of the preceding year). Against the background of these expenditures the share of expenditures on government securities for financing the budget deficit is 90.8 per cent (against 84.2 per cent at the end of July 2003). Highest is the relative share of expenditures on 7-year bonds - (36.2 per cent) followed by five-year bonds - 34.9 per cent and 3-year bonds - 12.7 per cent. The share of expenditures on government securities issued to finance structural reform is 9.2 per cent (against 15.8 per cent for the same period of 2003). Figure 7 illustrates the dynamics of the domestic debt expenditures structure during the first seven months of 2003 and 2004.

Figure 7. Expenditures structure of domestic debt (%)



Source: According to MoF data, Government Debt monthly bulletins

According to BNB and MoF data ("Government Securities Market" published by Fiscal Services Department and "Government Debt" bulletin) in the period April-June 2004 the average yield attained in the primary market on newly issued government securities for financing of the budget deficit was 2.95 per cent on annual basis for three-month treasury bills (three auctions during the period), 5.42 per cent for five-year bonds (one auction during the period), 5.31 per cent for seven-year bonds (one auction during the period) and 5.30 per cent for ten-year bonds (two auctions during the period). During the second quarter of the year no twelve-month treasury bills were issued.

Thus, with respect to the domestic debt market in April-June 2004, an increase in the yield attained on all newly issued

government securities was registered as compared to the first three months of the year. In comparison to the first four months of 2004 at end-July the share of securities issued for financing the structural reform has decreased in favor of securities issued to finance the budget deficit. The same trend is registered also when comparing with the first seven months of last year.

New financing

During the first seven months of the year new loans totaling BGN 390.5 m were received, against total foreign debt payments of BGN 2 061.4 m. During the review period the size of IMF borrowings is the most significant, amounting to BGN 121.2 m. The payments include repayment of principals in the amount of BGN 1 559 m and interest payments of BGN 502.4 m. Repayments were mostly made on Brady bonds – BGN 1 286.3 m. Net foreign financing as at 31 July, 2004 is a negative value and amounts to BGN -1 670.9 m.

Regulatory framework development

In May-July several important pieces of draft legislation were submitted for deliberation to the Budget and Finance Commission at the National Assembly, incl. a Bill on Municipal Debt, a Bill on Amendments to the Municipal Budgets Act, a Bill on the Tax-Insurance Procedure Code and a Bill on amendments to the Excise Duty Act. In view of the forthcoming discussions and adoption of the 2005 Budget, we would expect legislative efforts in the area of public finance to be stepped up in the course of the next few months.

The **Bill on Municipal Debt** submitted for deliberation on 15 July, 2004 and its implementing legislation that will amend the **Municipal Budgets Act** aim to facilitate the development of municipal lending as a result of which the rate of municipal investments and the quality of public services provided to citizens will be improved. The draft law lays down the definition of "municipal debt", the types of municipal debt, limitations to its amount, the procedures to choose a financing institution and issue municipal guarantees.

The draft law chose the approach to limit expenditures for the servicing of municipal debt and not the total debt both because of the limited crediting practice in the country at the moment and also because of municipalities' desire to be protected from excess liability, and also to guarantee the offering of key municipal services. The limit on the debt includes also guarantees issued by the municipalities that are considered activated for the needs of limitation. The scope of limitations does not include interest-free loans from the central budget to finance expenditures until they are reimbursed from European Union programs.

Two types of procedures are foreseen for the choice of financing institution – for long-term and short-term debt. In the

former case all creditors who have stated their interest and who meet the requirements of the Municipal Council will be eligible; following the assessment of offers negotiations will be held with the three candidates who submit the most favorable offers. For short-term debt there are provisions for the municipality to conclude framework agreements with the financial institution for a longer period of time by applying the long-term debt procedure or through direct agreement with a creditor in case the size of debt does not exceed 5 per cent of the municipality's own revenues. In addition, the bill sets two conditions which, if satisfied, will allow the municipality to guarantee foreign debt: when guaranteeing companies' debt with over 50 per cent of shares owned by the municipality which is guaranteeing the debt and when the loan was drawn to ensure financing for investment projects in favor of the local community.

The main goal in developing the draft Tax-Insurance Procedure Code (TIPC) is to introduce a clear, consistent, unified, integrated and, if possible, simplified process that guarantees the interest of the state to identify and collect all payable taxes and insurance contributions, avoid the use of "loopholes" in the law and the concealment of revenues and incomes. The subject matter of the draft law are the procedures for registration, servicing, identification and appeal of tax liabilities and compulsory insurance contributions carried out by the National Revenue Agency, as well as the collection of public receivables. The parties to such procedures are defined and the general framework of the types of taxpayers, their rights, obligations and responsibilities, their tax and insurance confidentiality arrangements, the competence of NRA bodies, the evidence, time-limits, the delivery of papers and notices, the termination and resumption of the proceedings, while at the same time making this framework generally applicable to the entire process of taxation and the identification and collection of compulsory insurance contributions.

The draft TIPC also provides some specific solutions that differ, to a certain degree, from currently valid legislation:

- the burden of proof in review procedures is transferred to liable persons only in some specific instances when there is a strong probability to circumvent the law, or artificial legal constructions are created for the purpose of non-payment of due tax and insurance contributions (transfer pricing, identification of undeclared incomes, income concealment);
- a single individual administrative act is introduced to establish all tax liabilities and compulsory insurance contributions; amounts paid in excess are respectively refunded;
- an obligation is introduced for NRA to deliver its report of findings to the audited person thus respecting the latter's right to file objections and to present evidence before the act is issued;

- for the first time there is a proposition to transfer the liable person's "burden of proof" regarding deals and relations to related persons and off-shore companies;
- for the first time there is a proposition to establish a procedure for information exchange with other countries outside cases regulated by international treaties to which the Republic of Bulgaria is a signatory and in conditions of reciprocity according to detailed requirements.

Unfortunately, due to the scale of the legislative initiative and the short period remaining before the end of the term of office of the current Parliament, there is little probability for the proposed changes to be put to practice in the course of the next few months. The introduction of the NRA in early 2006 will turn the systematic and efficient regulation of relationships in connection with the administering of taxes into a major fiscal policy challenge. The preparation of the draft TIPC is a step which must be followed by targeted efforts to establish an active implementing regulation in the medium-term perspective.

The major goal of the Bill on amendments to the Excise Duty Act recently submitted for deliberation to the Budget and Finance Commission is to synchronize and align national legislation in this area with the EU Directives. The change proposed in the draft law to shift the method of charging excise duty on alcoholic beverages from "final alcohol content per liter" to "hectoliter of pure alcohol" is in line with commitments made by Bulgaria to the European Union. The proposed increase in the excise duty levied on beer from BGN 1.05 to BGN 1.50 per hectoliter/degree Plato and for alcoholic beverages from BGN 0.05 to BGN 0.075 per degree of alcohol is in line with commitments made by the Republic of Bulgaria to reach the European Union minimum rates.

The change in the structure of excise duty levied on filter cigarettes, namely the increase of the specific excise duty and the decrease in the proportional ("ad valorem") excise duty is in line with the practice in most European Union Member States and will make future revenues from excise duties on cigarettes more easily predictable and insensitive to the prices set by producers. The structure of excise duty on filter cigarettes is modified, with specific excise duty going up from BGN 0.004 to BGN 0.0125 per piece while the proportional ("ad valorem") excise duty is lowered from 43.5 to 31.8 per cent of the retail price. The purpose of this change is to encourage the production of high-quality brands of cigarettes and protect the industry from illegal dumping practices.

Employment and Unemployment. Labor Market Policy

The lasting and sustainable trend of real decrease of unemployment in Bulgaria is preserved in all months since the beginning of 2004. In August 2004 the relative share of the unemployed against the economically active population is 11.9 per cent, registering a decrease of 1.10 percentage points against August of last year.

The favorable situation on the **labor market** is conditioned by the positive economic dynamics, the energetic demand of seasonal labor and the continuing large-scale implementation of government subsidized employment programs. According to data from the Ministry of Labor and Social policy, 290 thousand people have been covered by these programs since the autumn of 2002 which makes an average annual rate of about 100 thousand people. The highest contribution to such decrease has the program "From Social Benefits to Employment". The amendments to the Employment Promotion Act recently passed on first reading by the parliament create additional opportunities to open subsidized jobs and to effectively implement the information and intermediation functions of the labor offices.

Yet the preferences for hiring unemployed people remain insufficiently attractive to the private business, hence the need of further efforts to better inform and encourage potential business actors. Private enterprises have better labor organization and control, real conditions for employment and qualification.

While the results of the implemented programs for employment and decrease of unemployment are generally positive, there is still lack of precise assessments of their impact on the labor market and of the achieved social effect. There is particular need to develop and adopt national assessment criteria for the impact of these programs on the labor market which should form the basis of making future decisions on the utilization of the funds for active labor market policy.

Incomes and Living Standards

Unlike the previous year, the tendency of increase, though negligible, of the real incomes of Bulgarians was not preserved in 2004. While employment registers improvement, the incomes and the living standards of Bulgarians remain at low levels with no signs of noticeable improvement in a close perspective. Obviously, the new jobs are not high-pay ones, in other enterprises and sectors workers have not been paid for a long time, although they are not officially dismissed from work. According to NSI's data, real wages register negative growth by July 2004. Similar is the situation with the real money income of households.

The unfavorable trends observed in incomes and living standards are also reflected in the subjective assessments from sociological surveys. In July 2004 the consumer confidence

index from NSI's regular monitoring registers decrease by 1 percentage point against the April level. The downward trend is a result of the aggravated expectations about unemployment and inflation in the next 12 months.

An important event for Bulgaria's social policy was the presentation in July 2004 of the results of a multipurpose survey of households which is used as a basis for determining the **"poverty line" and the share of the poor population**. To date, this is the most authoritative and large-scale survey and its conclusions will be used to improve the policy on poverty and for more efficient allocation of social assistance funds. With the adopted poverty line of BGN 102 of monthly expenses per equivalent person, the poverty level is 14 per cent of the Bulgarians. Measured in Euro, the Bulgarian poverty line is about 10 times lower compared to the 15 EU Member States and over two times lower compared to the new members. The survey confirmed the influence of the basic poverty risk factors in Bulgaria – lack of education and qualification, the demographic structure of households, and unemployment. Every unemployed person increases the risk of poverty for the household in which he lives by 50 per cent; every employed person decreases this risk by 33 per cent. Most threatened by poverty are the large families with three and more children, single parents, single old people, as well as the young people up to 29 years. According to the ethnic analysis of poverty the Roma population is most affected, with 64 per cent poverty. The next task is to develop a poverty map for Bulgaria with parallel review of the measures and policies for alleviating poverty, with a view to determine with precision the guaranteed minimum income, the coefficients for access to the social assistance system, and to discuss variants for development of social services.

Social Partnership and Industrial Relations

The privatization and restructuring of companies and productions of national significance like BTC and Bulgartabac Holding are successful examples of modern industrial relations based on social dialogue and partnership. The Supervisory Board of Bulgartabac Holding resolved on the set up of a special **Fund to finance the social costs of privatization**. The objective of the fund, which will be registered and managed as a non-profit legal person for the public good, is to finance the social costs of privatization and the active employment measures and programs. Such a decision takes into account and balances the interests of workers and employees, tobacco producers, and investors.

The new collective labor agreement of BTC signed by all five syndicate organizations in the company took effect since 1 August 2004. It will be valid till the end of 2005 when company's restructuring is expected to get completed. Thus some of the most disputable personnel restructuring issues in the previous attempts to privatize BTC were solved. The collective agreement preserves the current social benefits of workers and regulates

the compensation schemes for voluntary leavers and for the laid off workers and employees.

Following some restriction of the powers of the National Tripartite Cooperation Council, this year the representatives of the nationally represented employers and syndicate organizations and the government decided to expand the range of living standard issues discussed by the council, including education and health care.

Social Security

Social Security Burden

The negotiations between syndicates and employers on determining the new minimum social security thresholds by economic activities and professions for 2005 are coming to an end. **The number of economic activities for which thresholds are determined is expected to increase from 55 to 69**, aiming to guarantee more equitable social security threshold levels conforming to the specific characteristics of the spheres in which insured persons work. **Syndicates and employers have already signed agreements on the thresholds for 48 economic activities.** The state is expected to determine administratively the thresholds for another 16 economic activities, because employers and trade unions have failed to agree on some of these, waived negotiations on others, and for a third part there are no syndicate representatives.

According to employers' calculations **the total social security burden for the business for 2005 is expected to increase by an average of 5.5 per cent** as a result of the agreed new higher social security thresholds, which are expected to increase by an average of 7.5 per cent. The forthcoming change in the distribution of the social security burden between employers and insured persons (70:30 in 2005 according to the Social Security Code against 75:25 in 2004) in favor of the business is expected to only partially compensate the effect of the higher thresholds. At the same time, in accordance with the Act on Guaranteeing the Claims of Workers and Employees in the event of Insolvency of their Employer, the 4 per cent contribution to the Unemployment Fund, which is divided between the employer and the insured person, will be decreased to 3.5 per cent and the other 0.5 per cent, which go directly to the wages guarantee fund will be fully borne by the business.

The expected higher social security burden for the business in 2005 will have a negative effect on the business environment and the efficient functioning of the labor market, which calls for **searching variants to lower the social security contribution levels.** **The new President of NSSI's Supervisory Board made a proposal to that effect.** His idea generally involves **allocation of funds from the fiscal reserve to NSSI, which should be actively managed in a long-term perspective of 25-30 years with a view to generate enough**

current annual income to increase pensions by about 10 per cent and to decrease social security contributions by about 4-5 percentage points. The expected effects of NSSI's partial operation on a funded principle as the second and third pillar of Bulgaria's pension system are towards encouraging entrepreneurship and employment, restricting the grey economy, meeting the challenges of the negative demographic trends, solving the problem of the annual deficit in the Pension Fund, increasing the level of pensions and the disposable income of insured persons and ensuring a balance of the conflicting interests of pensioners, employees and employers.

The proposal of the new President of NSSI's Supervisory Board can be assessed as interesting and deserving a public debate. There is a need to analyze a number of questions with a view to assess the strengths and weaknesses, the opportunities and threats of NSSI's capitalization. Some of them concern the choice of institutions to manage and control this huge state resource; the mechanism of and restrictions on the investment of the funds; guaranteeing a minimum annual yield, as well as the alternative variants of investment solutions. Other questions concern the expected effects on the growing current account deficit, the financial stability of the solidarity pillar of the pension system, the development of the supplementary mandatory and supplementary voluntary pension insurance, as well as the opportunities to restrict the dependence of the capital schemes on economic shocks and market conjuncture changes. **The partial capitalization of NSSI could prove a successful and politically acceptable move to guarantee the financial stability of the pension system in a long term perspective, with clear positive economic and social effects, but such an important step towards the development of the Bulgarian pension model should be carefully analyzed by experts and put to wide public debate.**

With a view to guarantee more equitable distribution of the social security burden among the employers in respect of the social security contributions for accidents at work and occupational illnesses and with a view to encourage the business to invest in improved working environment, **a work group comprising MLSP, employers' and syndicate representatives is seriously discussing the idea to introduce since the beginning of 2005 differentiated social security contributions for the employers according to three basic criteria – the costs of accidents at work and occupational illnesses, the frequency of accidents at work in the corresponding economic activities and the burden of such accidents.** Today all employers pay to NSSI one and the same percentage (0.7 per cent) of wages for the Accidents at Work and Occupational Illness Fund, and no account is taken of employers' investments in improved working environment and the level of accident at work and occupational illness risk in the different economic activities.

The differentiated social security contributions for employers are expected to vary within the range of 0.4 per cent (for the productions with the highest level of safety) and 1.1 per cent (for the productions with the highest risk level), and companies will be grouped in a five-degree scale to be changed on an annual basis depending on the current condition of the production risk in the different sectors. On an average for the country, the current amount of revenues from social security contributions for accidents at work and occupational illnesses is expected to be preserved, i.e. the only objective of the discussed change is to bind the amount of social security contributions to the quality of the working environment. It would be advisable for the formed work group to think about a method of accounting the efforts to improve the working conditions at company level in cooperation with sector organizations, with a view to enhance the effect of the differentiated contributions. The introduction of differentiated contributions for accidents at work and occupational illnesses involves higher system administration costs, which is another challenge of the proposed new method.

According to the amendments to the Public Servant Act passed at the end of July, public servants will now have right to 6 months unpaid annual leave for raising children up to 8 years. Until now only parents working under labor contracts had right to such leave.

Supplementary Pension Insurance

Data about the insured persons and the available net assets of pension funds as of end of June 2004 reveal that in the second quarter of 2004 as well the number of insured persons and the amount of the available net assets in UPFs register the highest growth (+2.12 per cent and +19.75 per cent accordingly). Against the end of 2003, i.e. for 6 months, total insured persons in all pension funds have registered increase of 3.33 per cent and net pension assets – of 20.54 per cent. **As at end of June 2004 available net assets of the supplementary pension insurance amount to BGN 615 390 thousand**, and experts in the field project that this financial resource will exceed BGN 800 m by the end of 2004. **Bulgaria's pension system assets are not yet used to actively increase the competitiveness of the Bulgarian business and the economy as a whole**, which is a vital requirement in view of Bulgaria's forthcoming membership in the EU in 2007. The structure of the invested pension assets is a proof of this unfavorable fact.

The upward trend of the relative share of assets in UPFs in aggregate pension assets at the expense of the relative share of assets in VPFs, established for a year and a half now, continues, which is a result of the increasingly higher number of insured persons in UPFs and the increase of the social security contribution to UPF from 2 to 3 per cent since the beginning of 2004. The relative share of assets in UPFs

in aggregate pension assets registered increase from 12.54 per cent at the end of 2002 to 22.34 per cent at the end of 2003 and 27.18 per cent at the end of the first half of 2004. To compare, the share of assets in VPFs in aggregate pension assets registered continuing decrease from 58.81 per cent at the end of 2002 to 49.49 per cent at the end of 2003 and 45.57 at the end of the first six months of 2004.

As at end of June 2004 **PIC Doverie AD holds the highest market share of insured persons in supplementary pension insurance funds (41.84 per cent)**. This pension insurance company accounts for the highest share of insured persons in UPFs and OPFs, giving in only to PIC Allianz – Bulgaria AD. **PIC Allianz – Bulgaria AD accounts for the highest share of pension assets (37.49 на сто)**. PIC Doverie AD and PIC Saglasie AD are ranked second and third by market share of pension assets.

The market concentration on the insurance market remains high. The three companies PIC Doverie AD, PIC Saglasie AD and PIC Allianz – Bulgaria AD account for nearly 80 per cent of all insured persons in supplementary pension insurance funds. Besides, these three companies hold nearly 80 per cent of Bulgaria's pension system assets.

In the first half of 2004 insured persons did not manifest great interest in changing their pension fund, notwithstanding the opportunity they were given in the beginning of the year. The results of changed participation and transfer of insured persons' assets from one to another pension fund, presented by FSC at the end of September prove that. **The relative shares of persons who have changed their participation in the period against the average number of insured persons is 2.09 per cent for universal pension funds, 5.52 per cent for occupational and 0.85 per cent for voluntary pension funds.** The relative shares of transferred funds against the average net assets amount is 3.25 per cent for UPFs, 9.17 per cent for OPFs, and 1.13 per cent for VPFs.

The daily assessment of the assets and liabilities of pension funds and of the individual social security lots maintained in levys and shares, introduced since 1 July 2004, is expected to increase the interest of insured persons in changing their pension fund, because now they can compare themselves the pension asset management results achieved by the different pension insurance companies. **In August the upward trend of the value per share in supplementary pension insurance funds was preserved and most funds register higher increase in August against July.** On one part the expected intensified competition on the social security market will give chance to the smaller pension insurance companies to increase their market share and on the other part it will be a driver of achieving higher yield on the invested social security assets.

Smaller UPFs and OPFs have already benefited from the first for 2004 official distribution of insured persons made by NSSI according to the new criteria. The latter place the focus on: the annual yield achieved by funds for a period of 24 months (having a weight of 34 per cent in the new formula for official distribution of insured persons), the amount of the management charges calculated by pension companies (having a weight of 33 per cent) and the number of the individual applications for participation in universal and occupational pension fund received in the latest quarter (having a weight of 33 per cent). The new criteria for official distribution of the persons who have not chosen pension fund by themselves are expected to encourage the competition of pension companies, which will result in improved quality of provided services on one part and in higher level of fairness in the realization of this process.

As at end of June 2004 the achieved weighted average annual yield on the invested assets of UPFs (11.60 per cent) as well as of OPFs (10.93 per cent) registered almost double increase against the mandatory minimum yield (of 6.98 per cent for UPFs and 6.62 per cent for OPFs accordingly), which proves that insurance assets are managed quite well. For the time being the management of assets in VPFs is less effective – the weighted average annual yield of these assets is 8.99 per cent for the period 1 July 2002 – 30 June 2004, but still it is higher compared to inflation growth and the average annual interest rate on deposits in BGN.

FSC's statistics shows that the supplementary pension insurance activity is now profitable for the insured persons as well as for the pension insurance companies themselves. According to data by FSC's Social Security Supervision Department, the pension sector reports a profit for the first half of 2004 to the amount of about BGN 376 thousand. So far the sector has been at a loss, with only PIC Allianz – Bulgaria AD reporting profit in recent years. Three companies report positive financial result for the first half of 2004 – PIC Allianz – Bulgaria AD, PIC Doverie AD and PIC Saglasie AD. To compare, in 2003 the pension sector reported a loss of about BGN 853 thousand. (6.5 times improved result against 2002).

Government-issued or government-guaranteed securities as well as bank deposits remain the basic financial instruments in which pension assets are invested. Nevertheless, it should be noted that higher diversification of pension fund portfolios has been observed. Increasingly higher number of assets in UPFs and OPFs is invested in corporate shares and municipal bonds and increasingly higher number of assets in VPFs is invested in mortgage bonds and municipal bonds. This reveals that the potential of increasing the competitiveness of the economy is being used. Pension insurance companies do not have yet investments abroad. This trend is expected to persist in a short term aspect notwithstanding MoF's Ordinance No. 6/13 July 2004 on the

procedure of investing supplementary pension insurance assets in foreign securities, on the types of foreign securities, the requirements for such securities and the regulated markets on which they are traded, which has been promulgated in the Official Gazette and enables PICs to invest social security assets in foreign securities bearing higher risk.

Foreign securities in which assets in supplementary pension insurance funds may be invested include debt securities with long term credit rating not lower than Standard&Poor's BBB- or Moody's Baa3 and short-term rating not lower than Standard&Poor's A-3 or Moody's P-3; shares or interests in funds investing in debt securities and shares; shares included in indexes of regulated foreign securities markets and put options of indexes and bonds traded at the regulated securities markets, with a view to lower investment risks. The ordinance allows for having investments in foreign securities made by investment intermediaries registered in any EU Member State and licensed for such activity according to the legislation at registration. A definition of regulated foreign securities markets is provided for the first time.

The liberalized regime for investment of social security assets in foreign securities bearing higher risk aims at encouraging investments of PICs abroad but according to experts in the field such trends are not expected in the near future. The basic reason for the lack of foreign investments by PICs is the fact that Bulgarian assets remain much more attractive financial instruments compared to those offered in the ordinance.

Table 10. Insured Persons in Pension Funds

	As of 31.12.2003	As of 31.03.2004	As of 30.06.2004	Variation against 31.12.2003, in %	Variation against 31.03.2004, in %	Share of insured persons by funds as of 30.06.2004
Number of insured persons in supplementary pension insurance funds	2294966	2328388	2371376	3.33	1.85	100.00
Number of persons insured in UPFs	1613875	1646205	1681064	4.16	2.12	70.89
Number of persons insured in OPFs	164943	165148	164742	-0.12	-0.25	6.95
Number of persons insured in VPFs	516148	517035	525570	1.83	1.65	22.16

Source: FSC, Social Security Supervision Department and own calculations

Table 11. Available net assets of pension funds

	As of 31.12.2003	As of 31.03.2004	As of 30.06.2004	Variation against 31.12.2003, in %	Variation against 31.03.2004, in %	Share of pension assets in funds as of 30.06.2004, in %
Total available net assets of supplementary pension insurance funds, thousand BGN	510544	567164	615390	20.54	8.50	100.00
Available net assets in UPFs, thousand BGN	114058	139694	167282	46.66	19.75	27.18
Available net assets in OPFs, thousand BGN	143817	157435	167673	16.59	6.50	27.25
Available net assets in VPFs, thousand BGN	252669	270035	280435	10.99	3.85	45.57

Source: FSC, Social Security Supervision Department and own calculations

Table 13. Structure of invested pension assets, in %

INVESTMENT INSTRUMENTS	TOTAL FOR UPFs		TOTAL FOR OPFs		TOTAL for VPFs	
	As of 31.03.2004	As of 30.06.2004	As of 1.03.2004	As of 30.06.2004	As of 31.03.2004	As of 30.06.2004
1. Government-issued or government-guaranteed securities	67.97	63.70	70.44	68.03	61.35	61.38
2. Securities accepted for trading at the regulated securities markets	7.62	7.58	7.43	7.33	7.55	4.82
2.1. Shares	2.60	3.63	2.33	3.26	3.78	1.72
2.2. Bonds	5.02	3.95	5.10	4.07	3.77	3.10
3. Municipal bonds	0.20	1.37	0.42	1.31	0.37	0.57
4. Bank deposits	11.46	13.08	11.38	12.37	18.95	18.16
5. Mortgage bonds	12.58	11.29	9.69	9.29	8.60	8.80
6. Investment estates	0.17	0.48	0.00	0.85	2.96	1.97
7. Derivatives of securities	0.00	0.00	0.00	0.00	0.00	0.00
8. Investments abroad	0.00	0.00	0.00	0.00	0.00	0.00

Source: FSC, Social Security Supervision Department

Table 12. Market shares of pension insurance companies as at end of June 2004

PENSION INSURANCE COMPANIES	MARKET SHARE, in %									
	By number of insured persons in UPFs		By number of insured persons in OPFs		By number of insured persons in VPFs		By total number of insured persons		By total amount of net assets	
	As of 31.03.2004	As of 30.06.2004	As of 31.03.2004	As of 30.06.2004	As of 31.03.2004	As of 30.06.2004	As of 31.03.2004	As of 30.06.2004	As of 31.03.2004	As of 30.06.2004
PIC Doverie AD	46.95	46.36	42.36	42.22	27.14	27.29	42.23	41.84	31.87	32.31
PIC Saglasie AD	12.16	11.93	18.67	18.07	6.33	6.27	11.33	11.10	10.00	9.84
PIC DSK – Rodina AD	5.80	6.00	3.99	4.13	4.33	4.50	5.34	5.54	5.00	5.01
PIC Allianz – Bulgaria AD	20.02	20.35	22.14	22.06	49.01	48.26	26.61	26.65	38.24	37.49
PIC ING AD	8.90	9.02	3.74	4.19	3.87	4.35	7.42	7.65	6.52	6.88
PISC CCB – Sila AD	3.13	3.23	3.72	3.68	3.21	3.18	3.19	3.25	1.95	1.94
PIC LUKoil Garant – Bulgaria AD	3.03	3.04	5.38	5.62	6.09	6.02	3.87	3.88	6.42	6.46
DZI – Pension Insurance AD	0.01	0.07	0.00	0.03	0.02	0.13	0.01	0.08	0.01	0.07
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: FSC, Social Security Supervision Department and own calculations

Table 14. Yield for the period 1 July 2002 – 30 June 2004, on an annual basis, in %

PENSION INSURANCE COMPANIES	UPFs	OPFs	VPFs
PIC Doverie AD	12.17	11.06	9.29
PIC Saglasie AD	12.17	10.89	7.70
PIC DSK – Rodina AD	10.57	11.47	6.88
PIC Allianz – Bulgaria AD	9.89	10.50	9.47
PIC ING AD	12.08	12.45	9.50
PISC CCB – Sila AD	12.10	10.87	6.83
PIC LUKoil Garant – Bulgaria AD	13.71	10.93	7.32
DZI – Pension Insurance AD *			5.97
Weighted average yield	11.60	10.93	8.99
Minimum yield	6.98	6.62	

Source: FSC, Social Security Supervision Department

* The yield of DZI – VPF is for the period of seven months from 1.12.2003 till 30.06.2004

Health Policy

The most important legislative changes in the health care sector in recent months concern the passed:

- New Health Act taking effect since 1 January 2005;
- New Ordinance on the terms and procedure of contracting medicines which are fully or partially payable by NHIF;
- Amendments to the Ordinance on specifying the basic package of health activities guaranteed from NHIF's budget;
- Amendments and addendum to the Ordinance on the criteria, indicators and method of accreditation of medical institutions;
- New Ordinance on the principles, inspection and certification of the Good Laboratory Practice and
- New Ordinance on the terms and procedure of participation of medical institutions in the international exchange of tissues and cells.

At the end of July, following a year and so of discussions on a number of disputable texts, MPs finally passed the most important document in health care, which regulates the public relations concerning the protection of people's health. The new Health Act repealed the Public Health Act, which was effective for thirty years and did not correspond to the modern Bulgarian health care model and the health needs of the people. It should be noted that **the new act laid the foundations for development of a national health care system but this is not the end of health reform's legislative regulation.** Overall, the Health Act regulates the framework conditions in the following eight spheres: national health care system; health protection activities; medical services; health protection of certain groups of people; mental health; medical education; medical profession, medical scientific research on people; medical science; administrative and penal provisions.

The health Act places the focus on the protection of people's rights to health and on guaranteeing these rights by way of different government policies; on the responsibilities of the different health care actors (the State, NHIF, health system workers and the whole society) and on people's personal responsibility for their own health and for protecting the health of other people. **Major points in the act** include clear definition of: the rights and obligations of patients; the basic factors having adverse effect on health; the regions with higher risk for health; the health protection of certain groups of people, mothers and children in particular; the responsibilities of the different institutions for providing quality medical care; introducing accreditation of labor medicine services and the medical expertise of the ability to work.

An essential element of the act is the introduced principle of informed consent for medical activities; any manipulation to be carried out by doctors and dentists will only be realized with the explicit approval of the patient. Doctors and dentists will be obliged to inform patients of the diagnosis and the nature of the illness, the treatment, its alternatives and the expected results and possible risks. According to the new texts patients should be informed about the price of any medical service, manipulation, treatment or medicine. **Since 2005 failure to undergo mandatory prophylactic medical checks, tests or immunizations will be punished by a fine. The ban on the direct advertising of alcohol takes effect since 2005 as well. For the first time smoking in indoor public places is prohibited with an act.**

Over 50 ordinances and rules are expected to get developed by the end of 2005 as by-law regulatory basis to the Health Act, which reveals that the **important discussions on public health issues are yet to occur.** It should be noted, though, that the new Health Act highlighted the basic problem areas of public health, which are topical for the modern development of Bulgaria's health care system.

MoH and NHIF are developing a concept and an integrated health care information system with a view to introduce the **so-called electronic cards in the health care system;** these will contain information about the health status of patients and about the insurance risk coverage from the respective funds, **which will help Bulgaria to meet in 2007 the challenges of the free movement of patients and professionals in Europe.**

At the end of the first half of 2004 the Minister of Health presented the results of the health reform implementation analysis; the conclusions and recommendations made in the analysis are expected to serve as a basis for the discussions on the new Health Insurance Code. **The lack of regular monitoring and assessment is pointed out as a major negative aspect of the implemented health reform.** The analysis of the health condition of the nation has been discussed in a wider socio-

economic context. According to the report the reasons for the negative health trends are complex and can be sought in the health care sphere as well as in the other economic and social development spheres. This calls for ensuring better synchronization in the work of the different institutions and implementing adequate measures to lay the foundations of the long-term sustainable economic and social development of Bulgaria.

While improvement of the basic medical and economic indicators characterizing the activity of medical establishments has been reported, **the accumulated liabilities of hospitals remain a major problem. According to MoH's data, as of end of July liabilities of hospitals amount to BGN 106 m, including about BGN 60 m of outstanding liabilities.** This was the basic reason to have additional BGN 76 m allocated to MoH's budget at the end of June by a decision of the Council of Ministers. BGN 51 m of this amount are allocated for payment of the debts of hospitals and the other BGN 25 m are expected to be spent for life-saving and life-supporting medicines provided by MoH under Ordinance No. 23. **Total revenues of hospitals for the first 6 months of 2004 register increase of 16 per cent against 2003, which is an encouraging factor for improved financial condition of hospitals in the future.**

According to MoH, major reasons for the new liabilities of hospitals accumulated since the beginning of 2004 include:

- Delayed signing of the 2004 National Framework Agreement, as a result of which NHIF does not make payments to hospitals on the basis of the new clinical paths and higher prices;
- Introduced subsidization of hospitals on performed activity basis, which encourages hospitals to accept patients treated so far by the special outpatient care. According to the new method, the equalizing subsidy from MoH is granted after the results for the past quarter have been reported, which involves untimely payment of the liabilities of hospitals;
- Eliminated direction of patients on a regional principle, as a result of which some patients are directed from municipal hospitals to the multi-profile and special university hospitals where treatment costs are considerably higher.

According to MoH, major ways to solve health system problems include:

- Increasing the funds for health care to 4.7 per cent of GDP for 2005;
- Rationalizing the hospital network by optimizing hospital structures, including by reduction of health structures and concentration and specialization of the medical institutions;

- Approving an integrated approach for the financing of hospital care institutions by transition from financing of structures to financing of activities – introducing the “case-mix” approach and diagnostically-related groups.

Syndicates, on the other hand, propose five urgent measures in health care to prevent the accumulation of enormous hospital care funds deficit. According to the syndicates two of these measures should be implemented in the next months. One of them concerns the implementation of **monitoring of the whole legislative and regulatory basis and of the available personnel, technological and financial resources in the system** with a view to identify the problem areas and develop an action plan. The other urgent measure concerns the implementation of **a comprehensive review of the structure of hospital health care.** The other three measures place the focus on the immediate covering of all debts of hospitals, introducing MoH structures with control functions in the regional health care centers and increasing the funds for health care to 6 per cent of GDP in 2005, while avoiding increase of the insurance and tax burden for the people.

The measures to solve the problems of the health care system proposed by MoH and the syndicates are insufficient to guarantee the sustainable development of Bulgaria's health care. Increasing the funds for healthcare as a percentage of GDP in 2005 will not yield the expected result if **there is lack of political will for:**

- Comprehensive restructuring of hospital care with a view to rational use of scarce resources;
- Realizing successful privatization of the medical institutions;
- Implementing effective measures to stop the process of the so-called “draining” of NHIF;
- Putting into operation an integrated information system in the health care sector;
- Developing efficient mechanisms for timely completion of the negotiations between NHIF, BDU and UDB on the new National Framework Agreement for 2005 and for
- Passing by the end of 2004 the new Health Insurance Code, which is expected to regulate the rights and obligations of the parties to the mandatory health insurance, the mandatory social health assistance and the supplementary health insurance.

Creating clear rules and mechanisms for the health care system operation should precede the release of the huge NHIF reserve in BNB, with a view to guarantee efficient utilization of health insurance assets. **There is a need to gradually increase the accreditation requirements for medical institutions,** with a view to guarantee improved quality of the provided health services. Extending the time limit for approval of the positive list of medicines, on the

basis of which the medicines for home treatment fully or partially payable by NHIF are determined, till 30 November 2004 creates **real risk that the new framework agreement for 2005 may well not take effect since 1 January 2005.**

The parliament is expected to pass by end of October the Act on Professional Organizations, so as to have the associations of nurses and midwives recognized as independent organizations in view of harmonizing Bulgarian with European legislation.

The true reason for the continuing chaos in the health care system is **the absence of a clear vision about the development of the health reform and the implementation of adequate health care policy.** There is lack of synchronization and consistency in the political efforts to establish the new financing model of the health care system, which has generated pessimistic expectations about the successful completion of the health reform in the near future, and it is the Bulgarian people that suffer most from this situation.

Government activity in the environmental area over the past months was characterized by progress in the normative regulation of the nuclear safety and radiation protection sector. The new strategic review of the state of the environment in Bulgaria has been prepared together with the future trends of government policy with regard to the collective and individual use of natural resources.

The National Environmental Strategy of the Republic of Bulgaria drafted by the Ministry of Environment and Water is already undergoing a process of public and expert discussion.

The National Environmental Strategy is drafted for the 2005-2014 period while the Action Plan /its draft is attached to the Strategy/ covers the 2005-2009 period. The new strategy reflects the country's current stage of political and economic development and is a response to specific pre-accession commitments made by Bulgaria to the EU. The objectives of future environmental policy seek to strike a balance between immediate requirements related to the process of EU accession and Bulgaria's goal to solve within several years some country-specific environmental problems such as the shortage of water in a number of towns and villages in the country, the intensive processes of soil erosion and damage, the consequences of pollution from closed-down ore and uranium mines, the cleanness of residential areas.

The Environmental Strategy analyzes several major activities affecting economic players.

A major challenge to Bulgarian industry is to keep the country's accession commitments related to integrated **pollution prevention** which requires an integrated approach to achieve the maximum overall reduction in the polluting emissions in the ambient air, land and water. The number of industrial installations subject to the requirements of the Directive on Integrated Pollution Prevention and Control is estimated at about 250; most of these still use production techniques, equipment and environment management systems that do not match the best available techniques. Companies operating these installations will need to invest considerably to achieve compliance with the best available techniques and other environmental protection requirements. In spite of the fact that during negotiations on the "Environment" Chapter Bulgaria agreed on extended deadlines for a number of installations (5 by end-2008, 1 by end-2009 and 35 by end-2011) the country also made a commitment to stop issuing final permits setting the terms for best available techniques for all remaining enterprises by end-2007.

Major accident prevention (also known as Seveso II) is applied to 67 installations containing hazardous chemicals and presenting a potential risk in case of an accident. The list includes enterprises from the chemical, petrochemical, mining and pharmaceutical industry. Warehouses for storage of expired pesticides also fall within this group. The requirements include

an accidental risk assessment and the introduction of safety measures, including response measures. For facilities at higher risk there is an additional requirement to develop contingency plans in coordination with local authorities detailing the action to be taken in case of an accident. The Strategy foresees that by end-2006 year all industrial enterprises should have defined their major-accident risk and should have drafted contingency plans in line with the requirements of the Environmental Protection Act. The measures planned by the government in this direction include arrangements to establish and apply "tax exemption schemes" for operators investing in the reconstruction and modernization of industrial enterprises as part of programs to achieve compliance and establish information, research and consultancy systems for the best techniques and practices in the area of environmentally friendly production.

The Environmental Strategy for the period ending 2014 also provides for specific **measures for other sectors of the economy** – energy (by increasing the proportion of electric power generated from renewable energy sources), agriculture (by 2007 the share of certified organic production is expected to reach 10 per cent of the total agricultural production, and in the long-term perspective - up to 30 per cent), development of sustainable forms of tourism etc.

The draft National Strategy and Action Plan deal extensively with the planning and allocation of **financial resources** needed to implement them.

As regards investments by private companies, the Strategy explicitly states that they "are not a subject of concern in the financial strategy because in the majority of cases these investments cannot be exclusively defined as environmental expenses. The bulk of funds to be spent by businesses over the next few years will be targeted at introducing "best available techniques". In this way, on the one hand, businesses will achieve compliance with environmental requirements, but on the other hand, they will dramatically improve the business parameters of enterprises, which is a benefit rather than a liability for the companies themselves". The quoted documents only discuss the expenditures to be made by businesses providing services in the sectors of water supply and sewerage, and also by companies which are currently state-owned. Pursuant to the "pollutant pays" principle, this type of investment will be financed both by the population and from municipal and government budgets. The same principle, when applied to the income-generating mechanism (and most of all to consumer charges), means that in the future consumers will not only cover the direct (operational) costs, but also (depreciation) capital costs, and "hidden" environmental costs.

Legislative process

As regards the development of environmental legislation, we should note the amendments to the Environmental Protection

Act, the overhaul in the regulatory framework of the radiation protection, radioactive waste management and use of nuclear energy, and the new regulations in the field of waste management.

With the adoption of the new Health Act (promulgated in August 2004) additional responsibilities are given to the Minister of Environment and Water in terms of **the organization, control and implementation of measures to reduce the asbestos pollution of air and water**. With the supplements to the Environmental Protection Act, the MoEW jointly with the Ministry of Health will draft implementing legislation to regulate the procedures and methods of asbestos control in particulate matter and defining the concentration of insoluble substances in asbestos-containing waste water. With the entry into force of the new ordinance in early 2005, another requirement of the environmental *acquis* concerning the prevention of asbestos pollution of air and water will be transposed in Bulgaria's national legislation.

A specific feature for the period is the **legislative regulation of radiation protection, radioactive waste management and the use of nuclear energy**. Newly adopted legislation includes a new Ordinance on the terms and procedures for acquiring professional qualification and specialized training in the use of nuclear energy, a new Ordinance on the basic norms of radiation protection and safe radioactive waste management, a new Ordinance on the safe radioactive waste management and a new Ordinance on ensuring the safety of nuclear power plants.

Some important aspects in the above mentioned implementing legislation deal with:

- the regulation of safety requirements for nuclear power plants and systems in the process of their design by implementing the "deeply-echeloned protection concept";
- the establishment of the terms, norms and rules for the construction, commissioning and operation of radioactive waste management facilities and meeting the radiation protection requirements;
- the introduction of three categories of solid radioactive waste – transitional, low- and intermediate-level waste, and high-level radioactive waste for the purpose of classification of the requirements for storage, sealing and efficient management;
- the establishment of workplace conditions and requirements in compliance with the principles of radiation protection;
- establishing the terms and procedures for the operation of the State enterprise for radioactive waste.

The terms for activity in the waste management sector and, in particular, issues related to the construction and operation of facilities for the treatment and disposal of waste are set out in **two**

new Ordinances by the Minister of Environment and Water- Ordinance № 7 of 24 August 2004 on the requirements to sites for waste treatment facilities, and Ordinance № 8 of 24 August 2004 on the terms and requirements to the construction and operation of landfills and other facilities for the treatment and disposal of waste. These pieces of legislation establish the procedure for the designation of terrains and facilities intended for activities of waste disposal and treatment and the requirements to operators for acquiring authorization to engage in such activities under conditions that create no risk to human health or environmental damage.

Of special interest to Bulgarian businesses and foreign investors is the adoption of a new piece of legislation establishing the responsibility of the state for the elimination of environmental damage incurred by past action or inaction prior to privatization, with the exception of privatization agreements concluded prior to 1 February 1999. Pursuant to **the Ordinance¹⁸ on the terms and procedures for establishing the responsibility of the state and the elimination of environmental damage incurred by past action or inaction, at privatization**, the state provides the financial resources for activities to eliminate the environmental damage with funds planned in the State Budget Act for the respective year, and funds provided by donors intended for environmental protection in the Republic of Bulgaria. For this purpose, the buyer in a privatization deal or its authorized representative, within 6 months of the date of acquisition of ownership over the stocks or shares of the privatized company submits to the MoEW a report on the assessment of environmental damage. The buyer's report also obligatorily includes a program for the elimination of environmental damage, the requirements to which are stipulated in the Ordinance. Where the buyer in a privatization deal or its authorized representative fails to produce the documents within the 6-month time-limit, the buyer assumes the entire responsibility for all factors polluting or damaging the environment as result of its current or past activity in the privatized installation regardless of the date of acquisition of ownership over the installation. The "Buyer" within the meaning of the Ordinance is any Bulgarian physical or legal person with less than 50 per cent of state and/or municipal interest, or a foreign national who purchased shares or stocks in a company or an autonomous part of an enterprise under the provisions of the Privatization and Post-Privatization Control Act. Persons who subsequently acquired title over the stocks, shares or autonomous parts, are also considered to be "buyers".

Financing of Environmental projects

Joint Implementation Projects as per the Kyoto Protocol mechanism

¹⁸ Adopted by Council of Ministers' Decree № 173 of 19.07.2004 promulgated Official Gazette, issue 66 of 30.07.2004

Bulgaria signed two agreements between the Dutch government and investors for the **purchase and sale of reduced emissions of greenhouse gases** for projects that won the fourth bidding procedure organized by the Dutch government. Successful bidders in the fourth bidding procedure are as follows: "Reduction of greenhouse gases through the gasification of Stolichna municipality" with "Overgas" AD as investor, and "Cogeneration Gas Plant Biovet, town of Peshtera". The total investment in the two projects amounts to about EUR 70 million while the quantity of reduced greenhouse emissions is over one million tons of CO₂ equivalent.

Projects aim to reduce the emission of greenhouse gases through:

- improved energy efficiency and reduced use of fossil fuels;
- upgrading of combustion and production processes;
- elimination of leaks along natural gas networks;
- increasing the carbon dioxide absorption potential of forests;
- use of renewable energy sources.

The environmental and economic benefits of implementation will improve Bulgaria's capacity to acquire gratuitous targeted investment and hi-tech environmentally friendly equipment. Bulgaria undertakes to transfer to the investor certain quantities of Claims on ERUs; for each project these quantities are negotiated between the two countries. Proposals submitted by companies for the fifth, final bidding under the program, are currently being reviewed.

ISPA Program

Bulgaria gets a EUR 49 m grant from the European Commission under the ISPA program for projects in the environmental sector pursuant to two financial memoranda signed in September worth a total of 91 m Euro. Funds under the first memorandum are earmarked for technical assistance and preparation of investment projects for Water and Sewerage companies in 13 Bulgarian towns and cities (Burgas, Yambol, Ruse, Vratsa and others) and for the preparation of future ISPA and Cohesion Fund projects for waste management in 6 regions. The second memorandum is for the construction of desulphurising installations for units 5 and 6 of TPP "Maritsa-Iztok 2" in line with Directive 2001/80/EC "on the limitation of emissions of certain pollutants into the air from large combustion plants".

BANKING SYSTEM

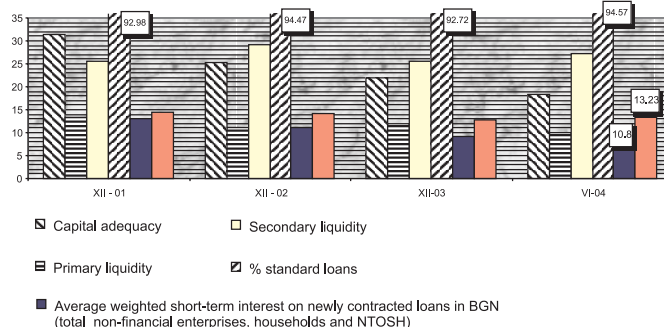
Financial sector and financial mediation in Bulgaria are dominated by the banking system. There are 35 banks, including 29 fully licensed banks for conducting operations in the country and abroad, and six branches of foreign banks. Since the beginning of the year credit expansion continued without slowdown. Nevertheless banks remain stable, with excellent indicators of capital adequacy and liquidity and well functioning banking supervision. Hitherto measures for restricting credit expansion taken or announced by the supervision and the government for more than a year did not produce the desired effect and were followed by new ones.

Banking system statistics

From January 1st, 2003 commercial banks in Bulgaria **started applying the International Accounting Standards**. This entailed changes in the format and structure of their balance sheets and income statements. From April 2003 Banking Supervision Department of BNB **has been applying a new grouping of commercial banks** (with the specification that the grouping does not contain rating elements and should not be interpreted as assessment of the financial condition of banks). A bank's place in a group depends on the size of its assets. Group one always comprises 10 banks, group two includes the other banks, and group three comprises branches of foreign banks.

According to BNB data, at the end of August 2004 the banking system assets totaled BGN 20,959,108,000 against BGN 17,323,643,000 at the end of 2003 (i.e. an increase of BGN 3,635,465,000 in the first eight months of the year). At the end of August deposits amounted to BGN 16,133,830,000 while at the end of 2003 they totaled BGN 13,593,516,000 (an increase of BGN 2,540,314,000 for the first eight months of the year). At August the net profit of the banking system was BGN 300,494,000 against BGN 379,817,000 in December 2003. According to BNB data, total capital adequacy of commercial banks at the end of June 2004 was 18.35 per cent (excluding group three) and at the end of last year this indicator was 22.03 per cent (25.22 and 31.32 per cent at the end of 2002 and 2001 respectively). At the end of June 2004 banking system primary liquidity was 9.9 per cent and secondary liquidity was 27.11 per cent (11.98 and 25.48 per cent at the end of 2003, 11.2 and 29.25 per cent in 2002, and 13.47 and 25.47 per cent at the end of 2001). These indicators are illustrated in Figure 8.

Figure 8. Selected banking system indicators (%)



Source: BNB data, monthly news bulletins

Thus assets, deposits and net current profit of the banking system continued growing. Growth in assets and deposits in the first nine months of 2004 exceeded considerably growth in the same months of 2003. Growth in assets is 21 per cent by August 2004 on December 2003 (against 10 per cent in the same period of 2003) and 19 per cent in deposits by August 2004 (against 9 per cent in the same period of 2003). **Growth in deposit base and growth in assets are factors for and indicators of ever more difficult slowdown in credit growth.** Net current profit of the banking system at the end of August 2004 already exceeded that in the same period of last year¹⁹. The ratio of net interest income to other non-interest income (the latter includes income from loan servicing) increased in 2004 (after 2.30, 2.25 and 2.21 respectively at end of 2001, 2002 and 2003, at the end of August 2004 it is already 2.38). Thus lending activity remains a primary source of income for the banks in Bulgaria. On the one hand, this reflects banks' efforts to avail of the opportunities presented by a more favorable economic environment and enhanced demand for loans by the business and the public. On the other hand, this suggests certain underdevelopment or insufficient diversification. The indicator of capital adequacy continued its downward trend but remained relatively high, well above the regulatory minimum, indicative of the stability of the system. Liquidity at the end of the half-year is slightly higher than in the first quarter. This confirms the conclusion that **the banking system in Bulgaria is stable, but has not utilized all possibilities for development and enhancing its effectiveness.**

Such a conclusion is also confirmed if comparing the size and credit exposure of banks in Bulgaria and other transition economies. Despite the growth in recent years, **Bulgaria is still lagging behind most Central and East European countries** and the region as a whole is well below the indicators of developed market economies (Table 15). This is a sign that **the Bulgarian banking system has a strong potential for growth, including through credit expansion, despite current disputes about the optimal rate of this growth.** At the end of 2003 net loans of the banking system to non-financial institutions and other customers made up a mere 26.2 per cent of 2003 GDP at current prices.

¹⁹ At the beginning of 2003 a major reintegration of provisions was effected, related to adoption of the International Accounting Standards, i.e. real income growth at the beginning of the year was even smaller.

Table 15. Bank assets and loans in Central and Eastern Europe, % of GDP (at end 2003)

Country	Assets	Loans
Bulgaria	50	26
Poland	65	31
Romania	33	18
Slovakia	83	34
Slovenia	89	42
Hungary	79	39
Croatia	105	61
Czech Republic	107	35
Average* for the 8 CEE countries	74	34
Average* for Euro area countries	201	102

* Non-weighted

Source: Bank Austria Creditanstalt, Banking in CEE, April 2004

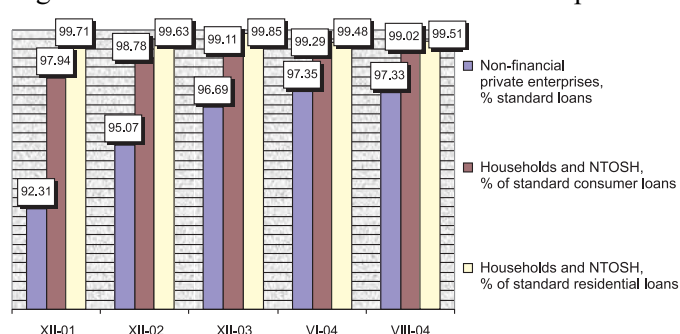
Domestic credit growth sustained (under currency board arrangement of note are loans from commercial banks to the non-government sector – non-financial state-owned enterprises, non-financial private enterprises, non-bank financial enterprises, households and other according to the sectoral classification). Out of BGN 4,442,871,000 at the end of 2001, receivables on loans to the non-government sector reached BGN 6,397,179,000 at the end of 2002. At the end of 2003 receivables on loans to the non-government sector already accounted for BGN 9,487,449,000 and at the end of August 2004 they totaled BGN 12,223,341,000²⁰.

Credit expansion in 2003 reported an **annual growth of 38 per cent in newly contracted loans of commercial banks** (from BGN 5,189.7 million in 2002 to BGN 7,159.96 million in 2003). In the first eight months of 2004 newly contracted loans reached BGN 6,228.53 million, against BGN 4,358.9 million and BGN 3,296.6 million in newly contracted loans for the corresponding period in 2003 and 2002. These data show that **in 2004 there is no slowdown in credit expansion** – growth in absolute terms and actual retention of growth on an annual basis are observed. For the first eight months of 2003 newly contracted loans grew by 32.22 per cent against the same period in the previous year, and in the first eight months of 2004 they grew by 30.02 per cent on the same period in the previous year. The conclusion is that so far the new measures of the government and the supervision (discussed below) for restricting credit growth did not produce the desired effect. It is possible however that this effect would surface in the coming months, as some of the measures have been only recently applied and also new ones have been announced.

The condition of the loan portfolio remains good – 92.72 per cent of all categories of loans of the banking system were standard at the end of 2003 (against 94.47 per cent at end 2002), and at the end of June 2004 standard are 94.57 per

cent (Figure 8). The general conclusion about the condition of the loan portfolio is also true for receivables on loans to private non-financial enterprises, households and NTOSH – the percentage of standard loans there is increasing or remains high in 2004 (Figure 9).

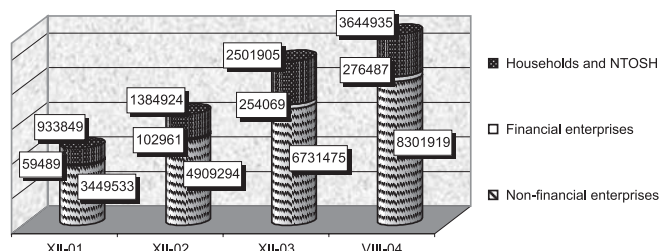
Figure 9. Condition of the loan portfolio



Source: BNB data and own calculations

Interest rates on short- and long-term newly contracted loans in BGN in mid-2004 are higher than those in the last month of 2003 (again Figure 8). Credit dynamics reveals other interesting trends (by currency, term and borrower). For example, review of receivables on loans to the non-government sector since the beginning of the year shows the highest absolute growth in loans to non-financial private enterprises, but the long-term trend reveals a growing share in total receivables of loans to households and NTOSH (from 21.02 per cent at the end of 2001 to 29.82 per cent at the end of August 2004, Figure 10).

Figure 10. Receivables on loans to non-government sector (BGN'000)



Source: BNB data, monthly news bulletins

Figures 11, 12 and 13 illustrate the dynamics of newly contracted loans for the first eight months of 2003 and 2004. As was stated above, the first eight months of the year confirm higher credit activity compared with the same period in 2003. As regards term and currency, **the trend toward larger share and higher growth in long-term loans in BGN and EUR than short-term ones sustained**. However, in USD-denominated loans there is no clear trend of preference between short-term or long-term loans compared with the same period of last year. In both periods however, short-term newly contracted loans had a larger share in USD-denominated loans. As a whole (total overdraft, short- and long-term loans) there is a certain decline in the volume of contracted loans in USD (and growth in loans in BGN and

²⁰ It should be noted that from the beginning of 2004 BNB, as part of the process of harmonizing monetary statistics with the requirements of the European Central Bank, adopted changes in the presentation of monetary statistics through the monetary report. Since February the sectoral classification under ESA'95 has been applied completely (e.g. introduction of non-trade organizations servicing households, NTOSH), which required reconstruction and revision of time series after December 1995.

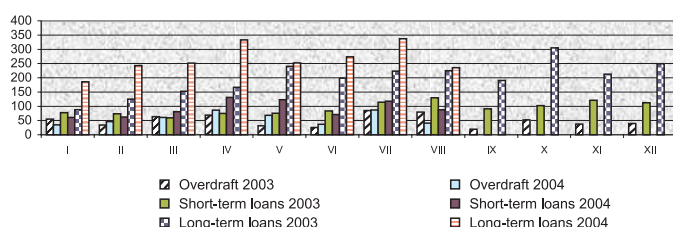
EUR, of course) compared with the same period of last year. The conclusion again is that this is probably consistent with higher investment activity in the country in line with currency risk rather than with interest dynamics or interest rate levels. Expectations about USD/EUR exchange rate dynamics are contradictory and therefore neutral in terms of currency choice when applying for loans. Existing currency risk in USD-denominated loans however (the euro being the reserve currency under a currency board arrangement) predetermines preferences to loans in BGN and EUR and this is specifically valid for longer-term loans.

Table 16. Changes in the structure of some assets and liabilities

	XII-01		XII-02		XII-03		VIII-04	
	BGN '000	% of total assets/ liabilities	BGN '000	% of total assets/ liabilities	BGN '000	% of total assets/ liabilities	BGN '000	% of total assets/ liabilities
Assets	9995321	100.00	11533708	100.00	13705432	100.00	15978414	100
Net foreign assets	3968500	39.70	2909504	25.23	1504314	10.98	1039886	6.51
Liabilities	9995321	100.00	11533708	100.00	13705432	100.00	15978414	100
Deposits with contracted maturity up to 2 years	4423218	44.25	4926377	42.71	5430159	39.62	6385683	39.96
Deposits contracted for use after notice of up to 3 months	1232095	12.33	1375995	11.93	1619867	11.82	1907016	11.93
Issued debt securities up to 2 years	-	-	3075	0.03	2335	0.02	2022	0.01
Deposits with contracted maturity over 2 years	14689	0.15	93561	0.81	201740	1.47	347613	2.18
Deposits contracted for use after notice exceeding 3 months	-	-	-	-	-	-	7	4.38
Issued debt securities exceeding 2 years	6341	0.06	15962	0.14	53981	0.39	141099	0.88

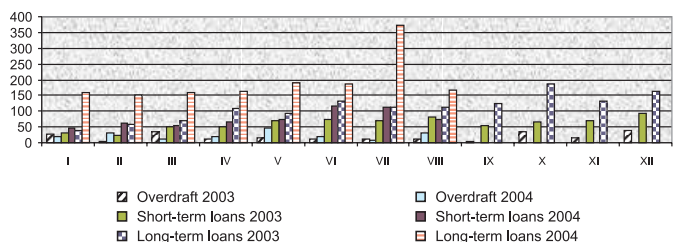
Source: BNB, analytical reporting of commercial banks

Figure 11. Newly contracted loans in BGN (million BGN)



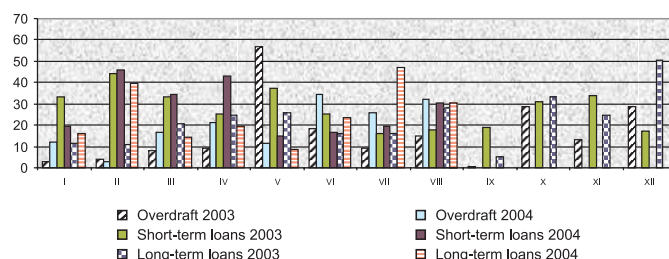
Source: BNB data, monthly news bulletins

Figure 12. Newly contracted loans in EUR (million BGN)



Source: BNB data, monthly news bulletins

Figure 13. Newly contracted loans in USD (million BGN)



Source: BNB data, monthly news bulletins

Overall credit growth and the higher volume of longer-term loans in recent years are offset by some changes in the structure of bank assets and liabilities. According to the analytical reporting of commercial banks, foreign assets declined most significantly in volume and share and some long-term liabilities increased most (Table 16).

The table shows that despite banks' strong efforts to attract more long-term deposits and issue longer-term debt securities on the local capital market, short-term deposits preserved their most significant weight in the structure of liabilities.

Ownership structure

Through various channels such as privatization, opening of representations, branches and newly established banks **foreign participation in the banking system of Bulgaria dominates both in control over equity and in terms of managed assets.**

In 2003 the last large state-owned bank was DSK Bank AD and together with Encouragement Bank it accounted for the last 14.2. per cent of the state share in bank assets (the municipal share was 2.4 per cent²¹). The deal for the privatization of DSK Bank AD was finalized in the fall of 2003 thereby **putting an end to the bank privatization in Bulgaria. After the sale of DSK Bank AD over 97 per cent of total banking system assets passed in private hands**²². Encouragement Bank AD and Municipal Bank AD remain the last banks with state, respectively municipal, control over the capital.

Measures for restricting credit growth

In recent months the discussion about possible **threats stemming from increased credit activity of banks** continued. Following the visit of the regular IMF mission in the country in the fall of 2003 the issues of the quality of loan portfolios and potential stability of the banking system gave way to the issues of the relation between import growth, current account deficit and credit expansion. IMF representatives have been persistent in their arguments of the need of restricting the banks' credit activity and BNB and the government accept their arguments in practice.

Despite the ongoing understanding of the benefits of credit growth for overall economic growth and the lack of immediate threat about the stability of the banking system, as soon as last year the BNB started announcing and taking a number of measures aimed at restricting growth in loans to private enterprises and households. The measures included firstly an **amendment to BNB Regulation No. 9** (Regulation No. 9 on the evaluation and classification of risk exposures of banks and the formation of provisions against impairment losses) as of August 2003. In the beginning of 2004 Regulation No. 9 was amended again²³, and banks' risk exposures were classified in four instead of five classification groups (former groups "doubtful" and "loss" were integrated in "non-performing" – over 90-day past-due payments).

The IMF report on the review of the stand-by agreement for Bulgaria of February 2004 specified three more **steps of Bulgarian authorities aimed at restricting credit expansion**. Firstly, BNB plans for decreasing minimum reserve requirements of banks were postponed. Secondly, the government²⁴ announced its intention to return the deposited (in mid-2003) funds from the fiscal reserve with commercial banks as soon as the term of deposits expires or even earlier. The government committed not to repeat such operations in 2004 with the argument that shifting a portion of the fiscal reserve to commercial banks creates conditions for additional bank credit expansion.

Thirdly, BNB confirmed its support to the joint project with the Association of Commercial Banks to launch by mid-2004 the single credit register which is to cover loans below BGN 10,000 (this limit was the minimum amount of loans at the beginning of the year – separately or jointly, of individual borrowers and

related persons – about which BNB maintained a credit register). The registration of all loans would allow the banks to cut considerably their expenses on assessment of creditworthiness, loan portfolio monitoring and risk management in general. To this end, in April 2004 **Regulation No. 22 on the Central Credit Register of Banks was amended**. Amendments entered into force on July 1st, 2004.

Other major regulatory changes in 2004 aimed at restricting banks' credit growth are as follows. Firstly, **Regulation No. 8 on the capital adequacy of banks**²⁵ was amended, introducing additional conditions for reintegration of retained earnings from previous years and current year in the capital base.

In addition, **amendments to Regulation No. 7 on the large exposures of banks** aimed generally at strengthening and elaborating supervision over banks' lending activity in relation to restrictions on their large exposures. **Amendments and supplements to Regulation No. 21 on minimum required reserves maintained by banks with BNB** came into force in June. The deposit base on which the amount of reserves is calculated was extended to include deposits and debt instruments with contracted term exceeding 2 years. For the latter the banks shall maintain reserves of 4 per cent²⁶.

Some of the above measures as well as other measures aimed at restricting bank liquidity by the end of 2004 are described in detail in the Memorandum of Economic and Financial Policy of BNB and the Government of August 6th. New measures for restricting credit growth were discussed during IMF visit in September. Among the discussed options were introduction of liquidity limits and raising the per cent of reserves on long-term deposits and debt instruments.

At the beginning of 2004 Bulgarian authorities expressed **expectation before the IMF that real annual growth in receivables from non-government sector will be restricted to less than 25 per cent at the end of 2004**²⁷. In mid-2004 IMF expressed a similar forecast, **25.9 per cent** nominal annual growth in receivables from non-government sector at the end of 2004²⁸. In August, however, BNB presented a **revised forecast** that "it is expected at the end of the year the annual growth of receivables from non-government sector to fall to some **30-35 per cent**"²⁹.

21 Calculations are based on assets at the end of 2002.

22 Calculated on the basis of assets at the end of 2003, the share of private banks in banking system assets is 97.52 per cent.

23 Changes came into force on April 1st, 2004.

24 Additional memorandum to the economic policy of BNB and the government, January 15th, 2004.

25 Effective as of June 1st, 2004.

26 As early as end of June there were rumors that this per cent will be raised to 8 in the fall, if credit growth did not slow down.

27 Additional memorandum to the economic policy of BNB and the government, January 15th, 2004.

28 Source: IMF, Public Information Notice No. 04/65, June 18th, 2004.

29 BNB, Economic Review, August 2004, p. 37. The same expectation was set forth in the Memorandum of August 6th.

The Bulgarian capital market develops successfully in 2004 but its contribution in overall financial mediation is still limited. Trade on the Bulgarian Stock Exchange - Sofia AD is active, with growing turnover, volume, market capitalization and bourse index on an annual basis so far. Trade in compensatory instruments and investment vouchers attracted further interest and still depended on current supply and expected government packages at public auctions held by the stock exchange. Despite improved indicators, of note is the lack of clear outlook for the market in the long run. Therefore the need for preservation and expansion of the existing potential requires active measures by institutions and market participants.

The role of the capital market in the Bulgarian financial sector is insignificant – at the end of August 2004 the total **market capitalization** of the Bulgarian Stock Exchange – Sofia AD was 8.8 per cent of the updated GDP estimate³⁰ for 2004.

The capital market is still unpopular in Bulgaria. This conclusion is valid when comparing Bulgaria with EU countries, especially the newly accepted ones. In absolute terms Bulgaria is lagging far behind (only Latvia has a lower indicator, Table 17). The state of the capital market does not reflect the immediate prospects to the Bulgarian economy as a whole but rather reflects the fact that the mechanisms of financing through that alternative non-banking environment are still unknown or not preferred even with available good investment projects. Even with ongoing macroeconomic development or development in individual industries or enterprises the effects on the capital market could be insignificant or surface out with great delay.

Table 17. Market capitalization in EU countries and Bulgaria (billion EUR)*

Eurozone (12), total	3929
EU (15), total	6302.1
EU (25), total	6403.4
Bulgaria	1.7
Estonia	3.5
Cyprus	3.7
Latvia	1
Lithuania	4.8
Malta	2
Poland	35.5
Slovakia	2.6
Slovenia	6.6
Hungary	17.1
Czech Republic	24.5

* Data on Bulgaria are at end-August, and for the other countries – at end-July 2004.
Source: Eurostat, Bulgarian Stock Exchange – Sofia AD.

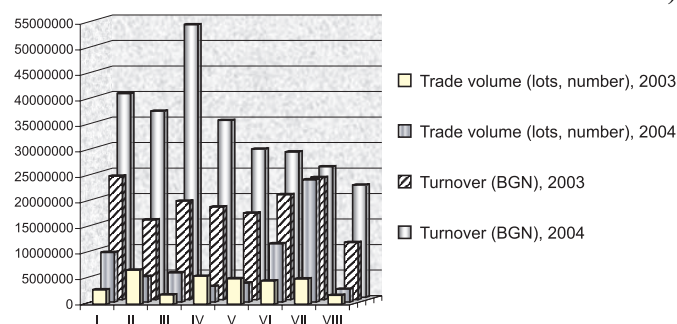
Liquidity increased but generally remained low and market stimuli are still insufficient to establish good practices of corporate governance even in some public companies. Investment alternatives are still limited and financial mediation in Bulgaria is effected predominantly through the banking sector.

Exchange trading (without privatization market and without compensatory instruments and investment vouchers)

According to exchange data, at the end of August 2004 total market capitalization was BGN 3,327,736,550 (including BGN 971,776,908 on the Official Market), whereas at the end of 2003 total market capitalization was BGN 2,722,008,207 (including BGN 985,984,573 on the Official Market). **Turnover** in the first eight months of 2004 is BGN 269,714,402 with 65,257,888 traded securities (lots). Excluded from this turnover and **trade volume** is the privatization market (e.g. the sale of residual state-owned shares in Petrol AD, Lukoil Neftochim – Burgas AD, Bulgarian River Shipping Company AD, and Bulstrad AD), as well as the rights, compensatory instruments and investment vouchers traded on the stock exchange. Block deals (without compensatory instruments and investment vouchers) are included in turnover and volume. Thus the volume increased by 80 per cent on the same period of last year. Trade volume rose by 95 per cent on an annual basis. Compared with the previous year, eight-month data on turnover and volume dynamics show that liquidity increased, but individual issues displayed different dynamics. Increases in prices of many of the traded securities, at practically unchanged liquidity, are the factor behind growing total turnover. Actually the SOFIX index is increasing on an annual basis (from 355.43 at the beginning of September 2003 to 559.26 at the beginning of September 2004), exceeding the historic 600 barrier for the first time in the second half of October.

Developments in exchange turnovers and volumes in the first months of 2003 and 2004 are displayed on Figure 14. Market capitalization has increased by 56 per cent for one year (Figure 15).

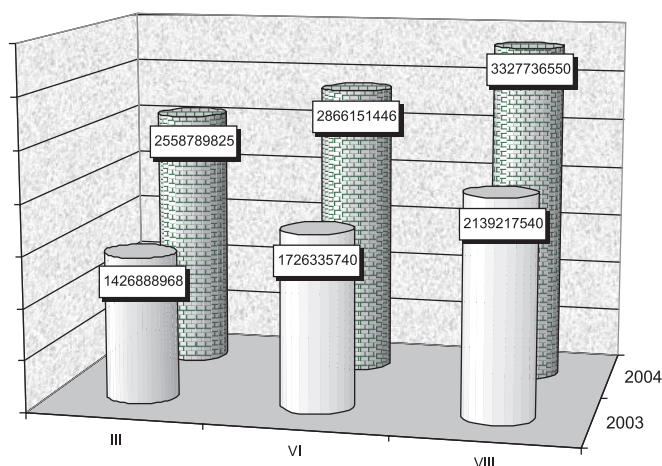
Figure 14. Trading on the Bulgarian Stock Exchange – Sofia AD (first eight months of 2003 and 2004, without privatization market, rights, compensatory instruments, and investment vouchers)



Source: According to data from the Bulgarian Stock Exchange – Sofia AD, monthly bulletins

30 At estimates of AEA, Macroeconomic Forecast for Bulgaria's Development, June 2004.

Figure 15. Market capitalization on Bulgarian Stock Exchange – Sofia AD markets at end of corresponding months (BGN)



Source: According to data from the Bulgarian Stock Exchange – Sofia AD, monthly bulletins

In the first eight months of 2004 major indicators characterizing the state of the capital market in Bulgaria (understood and measured traditionally through the indicators of Bulgarian Stock Exchange – Sofia AD) exhibited positive development. Low liquidity is still among the major problems, despite reinforced positive trends over the past year. The number of listed issues is high but liquid positions are few (most SOFIX securities plus some of the privatization funds). Sometimes this gives a distorted picture of the actual trade on the stock exchange³¹.

Among significant corporate news affecting trade were public companies' financial statements for the first quarter and for the first half of 2004. It was confirmed that market participants need and carefully monitor fundamental factors affecting the prices of stocks (specifically the financial information and the news about traded companies). Stock price dynamics, especially on liquidity positions, reflects to a larger extent corporate events, a sign of market participants' enhanced investment culture and improved market efficiency as a whole. Timely presentation of public companies' financial statements is already a practice, reflecting to some extent gradual recognition of the importance of good corporate governance in favor of minority stockholders and potential ones. In the past months the FSC again enforced several individual administrative acts obliging companies to present their reports for past periods.

In the first months of the year the **bonds market** of the Bulgarian Stock Exchange – Sofia AD operated at the usual capacity. By the end of August 240 transactions in corporate bonds were concluded in the Official Market of the Bulgarian Stock Exchange – Sofia AD, with total turnover of BGN 26 million. Transactions in corporate bonds on the Unofficial

Market numbered 201, with total turnover of BGN 35 million. Therefore liquidity on the bonds market is still below that in other securities markets.

In the summer months new issues of corporate bonds were listed for secondary trading on the stock exchange. Among these is the first issue of convertible bonds on the stock exchange (issued by Industrial Holding Bulgaria AD). Newly registered bond issues before that had been placed and fulfilled outside the stock exchange, i.e. again primary capital raising was not effected in the conditions of public offering. Private placement and subsequent registration on the stock exchange remain a preferred strategy for issuers, most probably in order to reduce the risk of unsuccessful placement while providing higher liquidity for investors. Banks' mortgage bonds are still popular bond issues, consistent with the growing share of mortgage loans in bank assets.

In September the shares of an **open-ended investment company**, Kapman Capital AD, were admitted for exchange trading. Thus open-ended investment companies traded on the Bulgarian Stock Exchange – Sofia AD became five. Together with the newly licensed KD Pelikan AD by the FSC in Bulgaria already operate six open-ended investment companies and two close-ended investment companies (not including the funds of Pioneer Investment Management SA, registered in Luxembourg two years ago, nor the funds offered recently by Capital Invest from Austria after the FSC confirmed the prospectuses for their public offering in August). This year the first **special investment purpose companies** were registered for trading: TBI – BAK – Real Estate AD and Capital Direct – 1 AD. At the end of August the Board of Directors of the stock exchange took a decision on listing a subsequent issue of TBI – BAK – Real Estate AD. Establishment and development of such companies is driven by the prospect of attracting free resources outside banks and their investment, given better yield opportunities offered by the Bulgarian capital (and generally financial) market.

In line with the expansion of the new schemes of collective investment, the interest in managing investment portfolios of institutional and professional investors is also increasing. New **management companies** entered the market. At present eight such companies are recorded in the registers of FSC.

At the end of June, following FSC registration and approval of the prospectus for initial public offering of stocks of **Investor.BG AD**, the issue was registered on the stock exchange (Primary Market segment). Through the stock exchange were offered 320,000 stocks (each with a face value of BGN 1, but at minimal issue value of BGN 3.30), or 53.33 per cent of the capital after the increase. Within 10 business days 10 per cent of the offered stocks were tendered in accordance with the rules of a mixed closed auction. On the third business day (23 July), following the first stage, the unsold stocks were offered.

³¹ For instance, some 30 per cent of the BSE Unofficial Market in August is due to two transactions (with stocks of Velina AD of Velingrad).

The results were as follows. From all offers, only 300 stocks remained unsold and sales were made at a price of BGN 3.34 per stock. The company attracted BGN 10,400 more than planned, and the stockholders in the company were over 100. Thus Investor.BG AD became the first company in the country to increase its capital through the stock exchange with initial public offering. The step of the management deserves a positive evaluation while the successful initial public offering again confirmed the potential of the Bulgarian capital market, unfortunately underutilized so far.

At the end of September FSC registered the company as public and then the stock exchange registered it for secondary trading. Again in September FSC confirmed another prospectus for initial public offering – of 20,000 stocks of **Interlogic Property AD** with a face value of BGN 10 and minimum issue value of BGN 40.

Trade in compensatory instruments and investment vouchers

Trade in **compensatory instruments** on the Bulgarian Stock Exchange – Sofia AD, after its launch in 2002, is still one of the key events in the capital market area. Interest in trade in compensatory instruments is comparable to that in stocks, despite the lower price dynamics over the past year (they remained at levels of about one-fourth of their face value) compared with the prices of most stocks. Inasmuch as this process is directly affected by exchange privatization (especially the sale of larger packages of more attractive companies) where payment is to be made with compensatory instruments, new appreciation and even higher intensification of trade in compensatory instruments can be expected.

A change in 2003 in the Transactions in Compensatory Instruments Act enabled the Bulgarian Stock Exchange – Sofia AD to technically conduct (after contractual assignment by the Privatization Agency) centralized **public auctions** for sale of stocks owned by the government and municipalities, as well as public auctions for sale of stakes in limited liability companies owned by the government and municipalities. This new option was mainly related to the privatization of non-public companies but indirectly enhanced the interest in the markets of the Bulgarian Stock Exchange – Sofia AD. The change confirmed the positive evaluation and confidence in the systems for trading and settlement of transactions already available on the capital market in Bulgaria.

Since the beginning of 2004 trade in compensatory instruments and investment vouchers has intensified. Statistics on trade in compensatory instruments and investment vouchers for the period January - August 2004 is as follows: 30,653 transactions in compensatory instruments with a turnover of BGN 80,152,093. The average monthly turnover for the period was BGN 10,019,012 (against BGN 5,422,472 only for the

last quarter of 2003). The data include both compensatory instruments and investment vouchers. Apart from that block deals in compensatory instruments and investment vouchers were registered on the stock exchange - 100 transactions with a total turnover of BGN 32,127,348, an increase of the average monthly turnover in block trade in non-cash instruments of payment (from BGN 990,955 in October – December 2003 to BGN 4,015,919 in January – August 2004). Compensatory instruments were traded (by the end of August) in 2004 within the range of 20.48 to 25.50 per cent of the face value. Prices followed the general trend towards increase, falling temporarily after the peak in March³². The appreciation of compensatory instruments is probably due to the already finalized privatization of BTC EAD and the new expectations for the planned sale of residual 20 per cent of the capital of the company against compensatory instruments on the stock exchange.

At the end of 2003 **investment vouchers** were traded for the first time on the Bulgarian Stock Exchange – Sofia AD. In November the Board of Directors of the stock exchange adopted changes in trading rules (specifically amendment of Appendix No. 6, adding investment vouchers to compensatory instruments). After the approval of these changes by the FSC, 134,132,876 investment vouchers of BGN 1 face value were registered on the stock exchange. The first exchange transactions in this instrument were effected on 24 November 2003. Initially interest was high and transactions were closed at some 17 per cent of the face value and then a fall followed. For 2003 the minimum price in bourse trade in investment vouchers was hit at 13.05 per cent of the face value, but in the first months of 2004 vouchers appreciated considerably. From January to August 2004 vouchers were traded at prices of BGN 14.01 to BGN 22.00 per cent of the face value³³. As with compensatory instruments, the general trend was upward. Maximum prices were reached in February – March.

Although the prices of investment vouchers almost approximated those of compensatory instrument at a certain point of time, the difference sustained however. The lower prices of investment vouchers than compensatory instruments reflects their limited use in privatization as well as the fact that their validity expired in mid-2004. In June however, a new amendment to PPCA was adopted extending the validity of the vouchers till 30 June 2005. The decision on extending the validity was taken at the last minute, after the price of the vouchers had already fallen. On the other hand, it was the extension of the term that raised the importance of the other factor affecting the price of investment vouchers – the possibility to be used as an instrument of payment in privatizations during public auctions organized by BSE. For the time being, however, privatization of attractive stocks and sales against investment vouchers is relatively limited.

³² New appreciation started in September and the level of BGN 0.26 per BGN 1 face value was reached.

³³ The maximum price was reached in August.

In order to expand the possibilities for sale of investment vouchers, in January 2004 the PA and the stock exchange for the first time started using in practice the trading system of the Bulgarian Stock Exchange – Sofia AD³⁴ for holding the first two auctions for sale of stocks and company shares against investment vouchers. Stocks of 432 companies were offered at the first auction (Centralized Public Auction bourse segment), and company shares of 86 companies were offered at the second auction (Non-Attendance Public Auction bourse segment). In addition to investment vouchers, it was possible to pay also by cash and compensatory instruments at these auctions.

The centralized auction since the beginning of 2004 was the third consecutive one since early 2003 (i.e. from so-called third wave of mass privatization), but the first one organized through the trade and settlement system of the Exchange. The non-attendance public auction (i.e. trade of company shares owned by the government and municipalities) was the first one from the “third wave of mass privatization”. In September 2004 the eighth centralized public auction and the sixth non-attendance public auction were announced. During the period the price of non-cash instruments of payment (compensatory instruments and investment vouchers) on the secondary market was affected to a great extent by the supply at respective auctions.

In summary, the practice of BSE privatization segment and of the centralized and non-attendance public auctions confirms **the success of bourse privatization** as a privatization method. The examples with successful sales of residual state-owned stakes in Petrol AD, Lukoil Neftochim Burgas AD, Bulgarian River Shipping AD, and Bulstrad AD are supplemented with examples of many other sales in which the government (municipalities) ensured both transparency and wide access of investors and attained a very good price.

Development of the legal framework

In the second half of 2003 the legal framework of the capital market in Bulgaria was amended significantly. The Financial Supervision Commission adopted several new (substituting the existing) regulations. These are: Regulation on the requirements to the activity of investment intermediaries; Regulation on the prospectuses for public offering of securities and disclosure of information by public companies and other issuers of securities; Regulation on the capital adequacy and liquidity of investment intermediaries; Regulation on the permits for conducting operations as stock exchange, organizer of unofficial market of securities, investment intermediary, management company and special investment purpose company; Regulation on the

requirements to natural persons effecting direct transactions in securities and investment consulting on securities and the terms and procedures for acquiring and revoking the right to exercise such activity; Regulation on the Central Depository of securities; Regulation on tender offering of stock purchase and stock swaps.

In 2004 the FSC continued its work on development of the legal framework. During the year the **Regulation on the terms and procedure for effecting margin purchases, short sales and borrowing of securities** was promulgated. Commission experts developed and presented for public discussion a **draft amending and supplementing POSA**. As stated in the official motives to the draft, the amendments aim at harmonizing the Bulgarian legislation with the *acquis* of the European Union in the field of securities or elaborating existing Bulgarian legal framework. The main amendments and supplements can be summarized in the following groups: changes in the regulation of the activity and respectively capital requirements to investment intermediaries; setting up a Compensatory Fund for Investors in Securities; changes in the part concerning public companies (mainly the terms and procedure for their transformation); introduction of a new type of scheme of collective investment in securities (the contract fund); amendments in the part concerning management companies.

There is also another major change – exclusion from the “prohibitive” list under PPCA of the **state holdings in Bulgarian Stock Exchange – Sofia AD and in the Central Depository AD, thus automatically announcing them for privatization**. This idea was put to public discussion and the issue of the state’s withdrawal from equity holding in the stock exchange was supplemented by the idea of transforming the exchange into a public company whose stocks to be registered for secondary trading and to be entitled to distribute dividends to its stockholders. The ideas provoked various comments and at this stage this could mean that market participants and various experts are not ready or at least are not unanimous about such radical changes in the status of the stock exchange. However, the practice of recent years does not preclude administrative enforcement of significant decisions in the capital market area.

³⁴ This was made possible after the Exchange’s Board of Directors adopted a new Appendix No. 8 to its rules and regulations at the end of October 2003, defining the terms and procedure for holding so-called non-attendance public auctions for sale of stakes in limited liability companies owned by the government and municipalities. Also for the purpose of conducting auctions contractually assigned by the PA for sale of stocks in government and municipal companies at the beginning of October the Board of Directors adopted a new Appendix No. 9 to the rules and regulations, stipulating the terms and procedure for so-called centralized public auctions.

The basic trend of improved business climate in the sector persists. The issues concerning the penetration of private capital in the sector register positive development. Dynamic development is observed in the process related to the construction of Belene NPP. The upward trend of liquid fuel prices continues reaching record breaking values, which will have a negative effect on the costs of some companies in the sector that intensify their activity in the winter season.

Government Policy, Restructuring and Privatization

The Energy Act and the Energy Efficiency Act were passed in late 2003 and early 2004. **The regulatory basis of the energy sector has been further developed by passing bylaws** to the two acts. The Ordinance on the regulation of electricity prices was passed in the beginning of 2004, followed by the ordinances regulating the pricing of thermal energy and natural gas. Rules on the licensing of the activities in the energy sector and on the connection of electricity consumers to the transfer and distribution networks were adopted as well.

Thermal energy prices will also be determined according to the basic price regulation methods laid down in the **Ordinance on the regulation of electricity prices** – “rate of return on capital”, “upper limit of prices” and “upper limit of proceeds”³⁵. The “net present value”³⁶ is added as a basic price regulating method for gas distribution enterprises. It should be noted that the bylaws to EA directly related to the privatization processes in the sector were passed on time with a view to build a clear legal framework for the private investors. Despite that, the time limit for passing all bylaws, which was laid down in the Transient and Final Provisions to EA, was not observed.

A procedure for organization of a competitive tender to issue natural gas distribution licenses for the territory of the West Region was initiated in relation to the processes of **gas distribution network development**. To date SERC has appointed the investors for two of the eight gas distribution regions and the advertised competitive tender procedures are now three. According to SERC, investors are interested in all three regions, particularly in the Thrace Region. This is probably due to the considerably higher number of potential consumers on the territory of the Thrace Region. The population of the Thrace Region is about 824 thousand people which ranks it second after the Serdika Region – Sofia Big Municipality with a population of over 1.1 m people. The most serious investor's competition will be for the license for Serdika Region³⁷, owing to both the large number and the high concentration of the population. The time limit set by SERC for construction of the individual parts of the gas distribution network on the territory

of the municipalities in the West Region is ten years after the natural gas distribution license takes effect.

Further steps were taken in relation to the **construction of Belene NPP**. NEK published public procurement invitations for appointment of architect – engineer to participate in the performance of activities under the Belene NPP financing and construction program and for appointment of a financial consultant to participate in project financing. The requirements set for participation in the two competitive tenders are sufficiently high and predetermine the participation of big and experienced companies. The companies awarded the public procurement shall be paid a fixed amount for the whole contract duration. The latter is a positive condition, given the current problems with the expansion and modernization of Sofia Airport. The advertised competitive tenders confirm again government's determination to build new nuclear power capacities and its willingness to start implementing the essential part of the project by 2005. The Minister of Energy launched the idea of contributing unit five and unit six of Kozloduy NPP as in-kind contribution to the Belene NPP building company. According to the available information, the state plans to contribute also the infrastructure built in Belene, as well as a nuclear reactor imported in the 1990ies.

Compared to the alternatives of providing government guarantees or signing long-term agreements for sale of electricity at fixed prices, this idea can be given a positive assessment. Increasing the production capacity and capital of the nuclear power plant construction company is a signal of its higher financial stability. That could result in lower investment risk and hence in lower project financing price.

A discussion of the results of the environmental impact assessment report on the investment proposal for construction of Belene NPP was organized in Romania. The experts who developed the report, representatives of the Project Management Group, of MEW and MEER, official representatives of the town of Belene and representatives of Romania's government institutions took part in the discussions. Based on the report results the effect of Belene NPP on the atmosphere and the air pollution risk for the environment and people's health are expected to be insignificant.

The privatization processes in the energy sector registered positive development as well. The proposals for purchase of the electricity distribution companies have been ranked. CEZ won the bidding for the West Package which comprises Sofia EDC, Sofia Region EDC and Pleven EDC. EVN Austria won the Southeast package comprising Plovdiv EDC and Stara Zagora EDC. E.ON, Germany won Varna EDC and Gorna Orjahovitsa EDC united in the Northeast Package. Total transaction amount for 67 per cent of the capital of EDCs amounts to EUR 693 200 000. This makes the above privatization transaction the biggest one in Bulgaria so far. According to MEER data, the

³⁵ For further details see The Bulgarian Economy, Center for Economic Development, July 2004.

³⁶ Ordinance on the regulation of natural gas prices.

³⁷ Bankja region, for which gas distribution licenses have already been issued, is not included in Serdika region.

“price per subscriber” for Bulgaria achieved in this case is EUR 230 against EUR 200 in the Czech Republic, EUR 100-150 in Romania and EUR 80 in Ukraine. E.ON and CEZ have already signed draft agreements with the Privatization Agency. The good selling price achieved as well as the smooth general progress of the processes speak of the good privatization results.

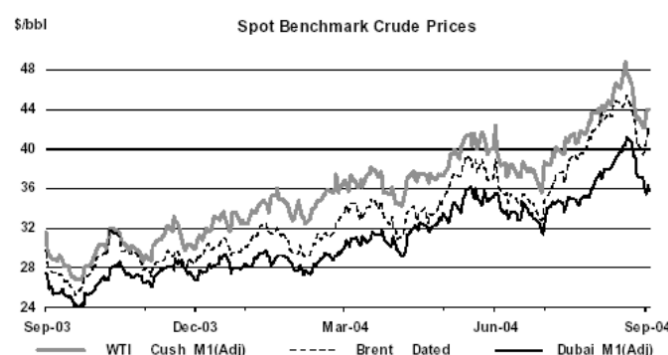
Attracting strategic investors was among the basic objectives laid down in the EDC privatization strategy. These investors are expected to ensure the necessary funds for rehabilitation of the existing infrastructure and to contribute to improved operational efficiency of the electricity distribution companies. This will be achieved by lowering the technological losses and most probably also by reducing the bad debts and electricity thefts. The transfer of the electricity distribution companies into private hands eliminates the social function of the state and the resulting problems with cutting the energy supply of defaulting payers.

The processes concerning the sale of the companies in the thermal energy sub-sector run in parallel to the EDC privatization processes. A consultant for the sale of TPP Bobovdol EAD, TPP Varna EAD and Toplofikatsia – Russe EAD has been appointed. Out of the five companies which submitted proposals, Credit Suisse First Boston (Europe) Limited was appointed to support PA in the sale and marketing of the three companies. The district heating companies of Loznitsa, Pravets and Razgrad were sold for a total amount of BGN 1 447 100. Following the chronology of the sale of the district heating companies of Loznitsa and Pravets, it should be noted that the initial unsuccessful attempts to sell these companies were probably due to the high initial tender prices. Therefore it can be stated that the sale by advertised competitive tenders will probably be a more efficient selling mode for the other companies. Such tenders will be organized for the district heating companies of Lovech, Burgas, Pleven, Gabrovo, and Veliko Turnovo. Potential buyers themselves will determine the market price of the companies.

Energy Prices

International market crude oil quotations reached new record-breaking levels. The Brent oil spot price exceeded the level of USD 40 per barrel. While prices went down to levels of about USD 35 at the end of June, a smooth upward trend was registered in the other months and in the beginning of September the price reached USD 41 per barrel. Since the beginning of 2004 till September Brent oil prices registered increase of 41 per cent accompanied by 4 per cent appreciation of the US Dollar. While oil prices register increase of about 40 per cent against early September 2003, the US Dollar registered depreciation of about 10 per cent against the lev. The decisive factors for the crude oil price increase included expectations of possible terrorist attacks, increased fuel consumption in a global aspect and incapacity for sizable increase of oil extraction in a short term perspective.

Figure 16. Spot Crude Oil Price Dynamics for WTI, Brent and Dubai Grades



Источник: Source: Monthly Crude Oil Price Report, International Energy Agency, September 2004.

The situation on the international oil markets is of decisive importance, because Bulgaria satisfies almost all of its needs from import under trade conditions following international market dynamics. These conditions and the above trends maintained the upward trend of oil product end prices in Bulgaria.

SERC and representatives of the district heating companies discussed changes in **thermal energy prices**. District heating companies submitted their proposals for price changes following which SERC developed draft Resolution on thermal energy price ceiling as of 1 October.³⁸ According to the decision, in the case of one-component price water steam prices will increase by 19.48³⁹ per cent, the price of the hot water carrier energy will increase by 4.5 per cent, while the output price will decrease by 8.6 per cent on a national scale. The change of Toplofikatsia – Sofia prices is as follows – water steam price is increased by about 28 per cent, energy (hot water) price is increased by 7 per cent and the envisaged output price increase is also about 7 per cent.

³⁸ SERC site: www.dker.bg

³⁹ According to own calculations, comparing the prices in SERC's draft resolution and the prices stated in SERC's Internet site as current thermal energy price ceiling.

While processes in the sector register delay in a comparative aspect, certain more intensive actions have been observed in recent months. Some necessary steps to create conditions for the entry of private capital in the management and for changing the ownership in the sector have been taken. Following the excise rates increase, the harmonization of the Bulgarian legislation with the European legislation was again a factor for development of the Bulgarian automobile transport. The reconstruction of Sofia Airport met with some financial problems. BDZ's management announced its vision of company's future development. The announced information about the progress in the concessioning of Trakia and Hemus motorways can be assessed as a surprise. The conditions for privatization of Bulgaria Air were adopted. Sea ports concessioning fell behind.

The necessary measures in relation to Bulgaria's accession to the EU were felt again in the area of **automobile transport**. According to the existing legislation regulating the activities in the field, a necessary condition for holding an automobile transport license is the financial stability of the carrier. For 2004 the financial stability of carriers consists in proving a financial resource of EUR 3600 for first automobile and EUR 2000 for each of the other automobiles. The extended time limit for proving the financial stability expired on 6 August. 826 companies failed to prove that they had the necessary capital and consequently the Minister of Transport issued an order for terminating the rights under the licenses of these companies. Over 90 per cent of the companies are for international cargo transportation and the other are for passenger transportation.

All this will result in lower number of actors on the automobile transport market in a national and regional aspect. Serious change in the market concentration and disturbed competitive structure of the sector cannot be expected because even after the companies which do not have licenses terminate their activity, the Bulgarian carriers on the market alone will be 3000 in number. For that reason at this stage changes in the price levels of transport services as a result of the European requirements for financial stability are not expected. Transport capacity deficit cannot be expected either. The financial requirements for the transport companies will increase on a year-to-year basis till Bulgaria's accession to the EU until they reach the European requirements. This will probably force some companies to withdraw from the sector, while others will begin to consolidate. It can be assumed that a large portion of the companies which cannot satisfy the financial criteria would withdraw from the sector even in the absence of such criterion because they would be unable to cope with the competitive pressure within the EU.

The initiative to eliminate the bilateral quotas for international automobile transport licenses since the beginning of 2005, which was started in July, has a positive effect on sector development. The declaration signed by the

transport ministers of the Southeast Europe, Black Sea and Caucasus countries provides for eliminating the transit quotas since the beginning of 2006. This will inevitably facilitate the activity of the transport companies operating on the territory of these countries and will result in intensified competition of carriers.

The Ministry of Transport set itself a time limit of eight months starting from the end of July **to concession the sea airports**. The draft for the concession of the civil airports in Burgas and Varna envisages giving both airports to one concessionaire. At the same, there will be individual airport activity license, investment program and master plan for each airport. The larger portion of investments is expected to be realized in the first five years of the concession, while the total concession period is 35 years. The future concessionaire will provide to the state a financial guarantee for fulfillment of the contractual obligations. The initial concession payment will amount to BGN 3 m and the annual amount will be a percentage achieved in the tender for appointment of a concessionaire, however not less than 12 per cent of all airport revenues. The future concessionaire shall:

- Be experienced in the management and operation of airports in not less than two countries;
- Operate not less than one airport with over 5 m passengers and one with over 2 m passengers per year;
- Have realized investments of over EUR 100 m in the last five years;
- Be financially stable;
- Have capacity to realize large investment projects.

According to MTC, the advantage of giving both airports to one concessionaire lies in the higher chances of appointing a strategic investor and in the opportunities to realize economies of scale. According to the ministry this should result in lower prices and better concession charges. It should be noted, however, that big concessionaires may well be attracted even if the airports are given to different concessionaires. On the other hand, with the existing monopoly of management and operation there is no guarantee that the concessionaire will lower consumer prices as a result of economies of scale. Being a monopolist, the company may use the economies of scale to increase its profit and not necessarily to decrease prices.

A consultant has been appointed to develop the tender documents and the concession agreement. The successful candidate is the Gide Loirette Noel and DZZD Arsov, Nachev, Ganeva consortium. It will assist the competitive tender commission in the procedure of appointing a concessionaire and in signing the concession agreement.

In August CoM adopted the long awaited strategy for the privatization of Bulgaria Air. The requirements to candidates laid down in the strategy predetermine the participation of generally big air companies. Financial companies will be admitted as well

provided that the air companies wishing to participate in the competitive tender procedures are three or less. According to one requirement the majority interest in the company should be held by Bulgarian physical or legal person or by foreign persons from EU Member States. This requirement restricts the competition on a territorial principle, which actually does not seem justifiable. The proposals of candidates will be ranked according to the offered price, the investment program, the goodwill and the experience of the company in the field. The time chosen to sell the company can be assessed as appropriate as the company still holds the service rights for a large portion of the destinations on the basis of bilateral agreements. Another positive condition is the profit realized in 2003 which amounts to BGN 1.5 m. The company ended 2002 with a loss and the profit for the first six months of 2004 amounts to BGN 2.4 m.

There were some problems in relation to the **reconstruction of Sofia Airport**. The latest obstacle was related to the sizable increase of steel prices on the international markets. As steel is a basic material used in the construction and repair works, this resulted in higher price of the new facility. For that reason a discrepancy between the funds initially agreed with the subcontractors and their current expenses occurred. An interesting question in this case is why such conflicts arise at all in the existence of signed contracts. One unused alternative is the application of financial derivatives to hedge such risks in the implementation of large projects of public importance.

A BDZ Development Strategy for the period 2004 – 2012 was announced for the purposes of **railway transport development**. The basic objectives laid down in the strategy include: “reviving” the railway transport, increasing its share in transport as a whole, liberalization, high quality and protection of consumers’ interests, as well as creating uniform conditions for competition of the different types of transport. The basic measures laid down for achievement of these goals include: management optimization by making BDZ a holding company and dividing the passenger and cargo services. Another important step envisaged in the strategy is compensating the free and lower price transportation for social purposes, which should in turn result in terminating cross subsidization. Repair activities for the existing wagons and locomotives, purchase of new ones, as well as other measures aimed at making the company a modern and competitive one are also envisaged. The details of the time limits and parameters of the individual measures are to be worked out.

The information that the company has paid its obligations to its employees which appeared in September can be interpreted as a sign of improved financial discipline in the state company. One should not forget, however, that significant efforts are needed to win complete financial independence from the state budget.

The current condition of the **road infrastructure** and the need of sizable investments to set this infrastructure in good

condition are the motives for the concessioning of Trakia and Hemus motorways. Information that joint-ventures between Bulgarian and foreign companies have been registered for the completion of the two motorways appeared in early September. Technoexportstroy EAD and Avotmagistrali EAD are the Bulgarian companies in the joint-ventures. The existing foreign interest towards the concessioning of Bulgarian motorways can be given positive assessment. To date, possible conditions of future concession agreements remain unclarified. There is certainly urgent need to build and repair the motorways.

There are many obstacles to allocating funds from the fiscal reserve for this purpose – an idea discussed earlier. The purely political aspect of such decision and the need to coordinate it with the international financial institutions generate high level of uncertainty and lower the chances to use this mechanism to finance the construction and repair works. Other possible financing sources include European funds and attracting funds from private credit institutions. Given the low interest rates in an international aspect, taking a loan may now prove advantageous. The existing financing alternatives and different opportunities in the management and distribution of the risk between government institutions and possible private concessionaires put forward the question of making an analysis on which to base the optimal choice.

The most significant event in the last months was the adoption at end of August of the long awaited **Bulgaria's Innovation Strategy** (the first draft of this strategy was presented in early 2002). The implementation of this strategy is expected to improve the environment for development and introduction of innovative products in the Bulgarian enterprises, which will certainly have a positive effect on the competitiveness of the Bulgarian economy.

The Strategy provides for implementation of ten basic measures to support and encourage the innovation processes in the country. These can be generally divided into:

1. Financial measures

- Setting up a National Innovative Fund
- Encouraging the employment of young specialists in small and medium-sized enterprises
- Building and/or optimizing technology centers

2. Non-financial measures

- Optimizing the "science – technology – innovation" system
- Training in entrepreneurship
- Creating clusters
- Implementing the European indicators for assessment of the innovative potential of industrial enterprises
- Creating and supporting existing technology parks
- Attracting foreign investments in research and development
- Creating entrepreneurship centers in the higher education schools

The adequate implementation of the objectives and tasks laid down in the strategy will guarantee improved innovative potential of the Bulgarian enterprises, which is a serious advantage for improving their competitiveness. We can only hope that the strategy will be implemented at a higher pace compared to its approval.

Some good news about the Bulgarian IT companies became known in the process of strategy's approval. These were related to Bulgaria's participation in the European Community's multiannual program for supporting the production, use and distribution of European digital content and for promoting the linguistic and cultural diversity of the information society (eContent). Owing to the good results achieved by local companies in two calls for proposals under the program, the successful Bulgarian projects will receive financing of about EUR 370 000.

Over 1000 organizations from 30 countries participated in the calls for proposals (the 25 EU Member States plus Norway, Iceland, Liechtenstein, Romania, and Turkey).

In Call for Proposals III of the eContent program (for feasibility studies) Bulgaria participated in 16 out of total 107 submitted

proposals. Of these only 8 have been approved for contracting and subsequent financing and Bulgaria has participated in 3 of these 8. Total budgetary allocations from the European Commission for the eight successful proposals amount to EUR 1 428 000 and the expected allocations for the Bulgarian participants amount to about EUR 150 000.

In Call for Proposals IV (for demo projects) Bulgaria participated with 27 out of total 168 submitted proposals. Successful proposals are 22 of which 2 with Bulgarian participation (one of these is ranked first). Total budgetary allocations for successful proposals amount to EUR 26 925 000 and the expected budgetary allocations for the Bulgarian participants amount to about EUR 220 000.

The cost of Bulgaria's participation in the eContent program is EUR 92 000 for the period 2003-2004, which is nearly four times less than the expected financing. This is an undeniable success and a proof that Bulgaria should accede on time to EU's regular programs thereby ensuring access of the interested Bulgarian organizations to European financing. At the same time, the good results achieved by Bulgaria clearly indicate that Bulgarian IT companies have the potential and the qualities to work according to global standards.

It is a fact that an increasingly higher number of initiatives and projects have a positive effect on Bulgaria's presence in the network. The BG Site – 2004 competition was organized again in 2004 for the sixth time in a row. The motto was now "Start here". The idea of this year's forum is to place the focus on the Bulgarian content in the network. Sites are registered from 15 July till 15 September and candidates can compete in 15 categories: e-Trade, Communities, Education and Science, Life Style & Entertainment, Arts, Finance, Government and Law, Health, News, Services, Sports, Travel and Tourism, Production and Industry, Personal Site, On-line Advertising Campaign.

The increased capacity for access to the global network provided by BTC-Net will have a positive effect on the Bulgarian Internet users. The company is a subsidiary of BTC and a major importer of ground Internet. Following the about 2.5 times increase total company's capacity is 465 megabytes per second. The increased capacity may also result in lower prices which will undoubtedly result in higher Internet consumption in Bulgaria.

The regular **report of Economist Intelligence Unit (and IBM)**, on the dissemination and use of information and communication technologies ranked Bulgaria 39 out of total 60 countries according to the level of preparedness for e-learning. For East Europe the Czech Republic is ranked highest (29) followed by Hungary (30), Poland (33) and Slovakia (35). Romania (41) and Russia (44) come after Bulgaria. The ranking is a result of the global assessment of the preparedness of different regions to use, create and improve Internet-based learning. Further

to the ranking, the objective of the study is to assess the achievements of the global leaders with a view to derive criteria and determine "the best practices" which should support the governments in their efforts to improve the quality and scope of e-learning to the benefit of the business, the education system and the society.

A major conclusion in the report is that there is a need of e-learning everywhere in the world. Internet-based learning narrows the knowledge differences by making the audiences wider and providing them with access to extremely important information. Major reasons for the increasingly higher use of e-learning as a form of education include:

1. For the business – to lower learning costs and maintain the qualification of its employees on the necessary level.
2. For schools – to reach increasingly higher part of the population and to respond to the needs of mobile and non-traditional students.
3. For governments – to expand the learning opportunities to cover a higher number of people and to maintain the qualification of their employees on the level of global requirements and standards.

The I-Center project of the Ministry of Transport and Communications was officially launched at the end of July. The project is part of the ministry's **I-Bulgaria** initiative and is implemented in cooperation with UNDP. A video-conference of the first 5 centers in Avren, Gotse Delchev, Dobrich, Lom, and Smiadovo was organized during project launch. The basic objective of I-Center is to provide access to information and communication technologies (ICT) to Bulgarians, particularly in the underdeveloped regions, as well as free access to e-government services.

The long-term objective of the project is to make it a kind of a portal for regional development and a local center for training and retraining in information technologies.

The I-Center project envisages development by the end of 2004 of 70 centers for complex information and communication servicing of the people. The centers will be basically built in regions with underdeveloped telecommunication infrastructure and lower employment and general economic development levels. Another 300 centers will be opened in Bulgaria by the end of 2005.

The Communications Regulatory Commission issued **voice service provision licenses** to another six companies. Two licenses each – for fixed voice service via the telecommunication network and for provision of access to the network of another operator – were issued to Spectrum Net, Trans Telecom and Vestitel BG. Telecom Partners Network and Bulgaria Telecom Net will provide only fixed telephone service. Gold Telecom Bulgaria will now provide cheaper conversations via operator.

The project for updating the Sector Policy in telecommunications as of 2004 was announced in mid August. The strategy is updated in accordance with Art. 7, Para 3 of the Telecommunications Act. The updated document contains brief review of the implementation results of the current sector policy and a detailed description of future tasks to be performed in the next few years (2009). The specific implementation deadlines resulting from the adopted update are attached as an annex.

The sector policy implementation guarantees adequate and timely development of telecommunications in terms of Bulgaria's commitments in respect of its accession to the EU.

According to **an analysis by experts from the European Commission (EITO)**, this year the mobile voice services and fixed data transfer services markets in Bulgaria will reach volumes of EUR 734 m and EUR 125 m accordingly. In 2003 the total volume of Bulgaria's information and telecommunication technology market was EUR 1.74 b, while according to 2003 data from EC the IT market alone reached a volume of EUR 312 m.

This year the figures may well be higher, given the running e-Government project and the stated ideas to modernize the equipment in the educational institutions. The spread of Internet will also contribute to the higher volume of the different segments of Bulgaria's ICT market.

According to the 2003 **IDG-Bulgaria's annual rating** of the leading Bulgarian ICT companies BTC is logically ranked first by annual revenues – BGN 1 027 910 thousand, registering however a decrease of 0.1 per cent against 2002. Company profit amounts to BGN 308 524 thousand. In that period BTC was still in Bulgarian State ownership and had 24 000 employees. According to the same criteria Mobiltel is ranked second. The operator's revenues amount to BGN 844 918.6 thousand, registering a growth of 12.5 per cent. Cosmo Bulgaria Mobile EAD realized revenues to the amount of BGN 198 195 thousand, which rank the company third in the rating with an annual growth of 116.9 per cent. Orbitel is ranked 16 in the general rating with total revenues of BGN 14 291 thousand, but it is a leader in the ranking of the alternative telecoms offering Internet as well as voice services.

In the period under review very interesting development was observed in terms of the opportunities to use Internet in school. The Ministry of Education and Science announced that it will request to have BGN 30 m allocated in the 2005 budget for building 700 computer labs and the necessary Internet infrastructure in the schools. This request is part of the ministry's strategy to have computer labs in all schools by the end of this government's mandate. The strategy will be implemented in three phases. First, 50 information centers for training and improving the qualification of teachers will be

created. The implementation of this first phase of the strategy is not less important than providing the material basis for labs in the educational institutions, because the absence of qualified teachers in information technologies may corrupt the implementation of this otherwise wonderful idea.

At the end of July the Council of Ministers adopted a **Strategy for introduction of universal mobile telecommunication systems** (UMTS – the so-called third generation systems). Strategy implementation involves fulfillment of two basic tasks – providing the necessary radio frequency resources and licensing the telecommunication operators that will provide UMTS services. The UMTS technology is many times better than the opportunities of the currently existing 1 and 2 generation systems, basically in terms of the opportunities for high speed data transfer. Bulgaria is one of the few countries in Europe that has not yet issued licenses for third generation mobile operators. At the same time the experience of other countries shows that the initial unprecedented interest in UMTS licenses by the telecommunication companies is very much like the case with the Internet “balloon” which burst at the end of 1999 and brought to collapse a large portion of the companies engaged in information technologies. It turned out that the consumers are not yet ready to pay more to use the expanded UMTS services, and for the time being the costs of the telecommunication companies for the provision of these services exceed many times their potential revenues. That is why there is certain delay in the global penetration of the third generation of mobile networks, which is fully explainable given the above circumstances.

According to the commitments laid down in the strategy, the frequency range of 1920-1940 megahertz had to be released by 30 September 2004. Together with the free frequency resource in the 2110-2170 megahertz band it is sufficient to start the two operators. The Ministry of Defense is to release the whole range of 1900-1980 by 2008. Following completion of the first phase (by 30 September 2004) the Communications Regulatory Commission should start a procedure for licensing on a tender or competitive tender basis of two third generation mobile operators. The strategy envisages to have the provision of UMTS services to customers started by the end of 2006.

Number of Tourists and Revenues from Tourism

According to data from the Ministry of Economy, the number of foreign nationals who visited Bulgaria in the period January – August 2004 totaled 3.3 m of which 2.9 m people visited the country for holiday or vacation. Greece accounts for the highest number of tourists – 437 470 people, followed by Germany – 428 895 people, and Great Britain – 199 950 people. The number of tourists from the EU (new members excluded) registers growth at a higher pace compared to the other markets. Against an average **growth in the number of foreign tourists** of 18.4 per cent in the period January – August, EU countries register an increase of 28.3 per cent. The European market is increasingly becoming a major tourist market for Bulgaria.

The number of Russian tourists registers increase reaching 109 703 people for the first eight months of 2004. Bulgarian resorts are regarded as most advantageous in terms of prices for Russian tourists. The visas introduced for passing through Romanian territory as well as the strong competition on the Russian market create problems. For that reason MoE prepares a special strategy for the Russian market envisaging diversification of provided services with special focus on winter tourism and targeted proactive advertising.

Notable is the growth in the number of tourists from the Czech Republic by 39 per cent and from Poland by 59 per cent (for the period January – July), which indicates expected reestablishment of Bulgaria's position on the tourist market of these countries.

Experts' expectations about tourism development in 2004 are very optimistic – over 4 m tourists and about USD 2 b of revenues from foreign guests, yet the figures are still far lower compared to our major competitors in the region.

The number of Bulgarian nationals who traveled abroad registers increase. Most frequent destinations remain Turkey, Greece, Serbia and Montenegro, followed by Germany, Macedonia and Romania.

Revenues from tourism for the first half of 2004 (January – June) reached EUR 646.3 m registering an increase of 25.1 per cent against the same period of last year. Revenues from tourism for the period January – July 2004 amount to EUR 976.2 m, registering an increase of EUR 187.7 m or 23.8 per cent against the same period of 2003 (EUR 788.5 m), owing to the higher number of foreign tourists who visited Bulgaria.

The balance in tourism for the period January – July 2004 reached EUR 558.2 m, accounting for 2.9 per cent of GDP against EUR 451 m or 2.6 per cent of GDP for the same period of last year.

Characteristics of the Competitive Environment

Against the background of the other countries in the region the issue of **Bulgarian tourist services competitiveness** is very interesting. Turkey is still offering the most advantageous services in terms of the price/quality ratio. Certain increase in the value of offers for Bulgarian nationals is observed, but Bulgarians going to Turkey preserve their highest share in the number of Bulgarians traveling abroad.

Prices in Greece preserve their top position on the Balkan Peninsula, particularly prices in food establishments. Besides the quality of hotels registers gradual decline as recent years did not witness any sizable investments in hotel base renovation.

Croatia is particularly popular among tourists from Western Europe and Russia – in 2003 revenues from tourism amounted to USD 5.6 b with number of tourists exceeding 7 m people. The Ohrid Lake in FYRM is another attractive destination on the Balkans. In recent years Romania appears on the international tourist market mostly with its mountain resorts in the Carpathian Mountains and some sea resorts (Mamaia, for example).

According to experts major **competitive advantages of the Bulgarian tourist product** include favorable service price/quality ratio and quite high level of security and peace in the country. Notable is the fact that this year Bulgarian tour operators and hotel managers started to implement much more result-oriented and flexible policy particularly with respect to Bulgarian tourists – all inclusive holidays are increasingly offered to Bulgarian nationals at very advantageous prices and good service quality. Thereby a step is made towards solving an obvious problem of tourism – the lack of proactive policy towards Bulgarian tourists and outflow of financial resources to neighbor countries.

Another positive trend is the changed supply structure which allows for attracting more solvent tourists. Improved servicing and diversification of the services provided in big complexes are also observed.

Problems in Tourism

The chaotic and off-hand construction in the big sea resorts remains a major problem of tourism. **A risk of oversupply of beds** is gradually emerging. This problem was more clearly outlined in the ending active summer season – the increase in the number of tourists is lower than the increase in the number of beds in the Black Sea resorts, i.e. the supply of beds is higher than the demand. Some Black Sea hotels are not fully booked which explains the more advantageous offers for Bulgarian nationals. It was for this reason that in the beginning of the season some hoteliers expressed their fears that the season will not be a success. Such a feeling was also intensified by the detained growth in the number of tourists from Germany – the

basic market for Bulgarian tourism. These negative expectations did not come true in the long run; they were neutralized by a more flexible policy on the part of managers and tour operators, which is yielding positive results.

The delayed construction of new sites generates problems as well. It has a negative effect on Bulgaria's image and may well make the foreign tour operators refrain from prepaying tourist holidays. Big tour operators work according to several basic schemes: they prepay tourist holidays thereby providing funds to hoteliers who make investments in new construction or renovation of the hotel base. The second method is financing against commitment of owners to repay by providing tourist services in the next few years (3 to 5). These methods have advantages as they provide financial resources and customers.

According to sector experts, hotel prices along the Black Sea coast have reached their maximum. Possible continuing increase may well result in reflux of tourists. Consequently there is a need to maintain this price level while improving the service quality, with a view to preserve the competitive position of Bulgaria on the international market. In any case there is a need of more flexible policy – offering lower prices at season start and end; for early reservations; last-minute offers; all inclusive offers, and employing other methods to attract tourists and ensure full booking of the hotel base.

Investments in Tourism

Along with the sizable investments in special infrastructure along the Black Sea coast, opportunities are sought to renovate the mountain resorts base. A project for renovation of the oldest **winter resort – Borovez** was launched in the last months. The project is an ambitious one and if implemented, it will make this beautiful Bulgarian resort a modern one and able to successfully compete with the fast growing Bansko.

The project, on which the Municipality of Samokov, the Regional Government of Sofia and private investors are already working, envisages construction of a resort complex Samokov – Borovez – Beli Iskar. Project implementation will start in 2005 and the resort will be divided in three price zones with different type of construction. Investments of about BGN 300 m are expected (minimum BGN 100 m) in hotel base and ski facilities. According to initiators the project should be completed by 2009.

The first zone – the so called **Low Borovez** – will be located 6 km away from Samokov at a height of about 1100 m. Construction of houses of the Bulgarian Revival type, family hotels and villas will be allowed in this zone. The Municipality of Samokov prepares the incorporation of a joint-stock company to manage Low Borovez. Partners will include the municipality and private investors.

The second zone – **Mid Borovez** – will be located at a height of about 1300 m and will cover the current resort Borovez. Investments to increase the number of beds to 10 000 are envisaged for this zone. The third zone – **Super Borovez** – will be located at a height of 1600 m. It will be the most expensive one with only 4 and 5 star hotels.

The resort is expected to become a place suitable for both summer and winter tourism. There is a need however to make very good planning of the resort in terms of the construction of hotels and new facilities, ski-tracks and lifts. This means to have an integrated resort plan adopted with a view to avoid the mistakes made in the construction of some other complexes (mostly along the Black Sea coast). That will allow solving easily all problems with the construction of infrastructure, water treatment plants, parking lots, transport facilities, sports basis, attractions and entertainment places for kids and adults.

There is a need to comply with the requirements for environment protection and preservation of one of the most valuable riches of Bulgaria – its natural resources. No less important is correct study of the potential markets for the services to be provided by this resort which should be developed as a winter and summer tourism center.

Overall, the capacity of the complex is expected to increase to 14-18 thousand beds (it is currently about 7000 beds). A four-seat lift is currently constructed on the track of the one-seat, a new four-seat lift is also constructed in the Kotvata locality. The two will have a capacity of about 2400 people per hour. The so-called "green" track from Markoudzhitsite to the current Borovez is also under construction. It will allow for choosing different routes which will be usable in the summer season as well.

The project will have a multilateral effect – its implementation will solve the unemployment problems of Samokov and the neighboring regions where the current unemployment level exceeds 28 per cent. A wide discussion, consultations and assessment by the Ministry of Environment and Water are envisaged. If the project is realized by 2009, Bulgaria has chances to apply for host of the Winter Olympic Games in 2014.

Alternative (specialized) tourism

The alternative (specialized) tourism which includes all forms of tourism other than the mass one – cultural and historic, ethnographic, rural, adventure, etc. continues its successful development as well. The specialized tourism is of vital importance for the development of most mountain and rural regions which do not have another alternative. This is mainly a small and medium-sized business which needs serious support in terms of the construction of infrastructure, family hotels, attractions, preservation of cultural monuments, etc. Financial

resources for this type of tourism are allocated mainly from the PHARE Program which provided support to over 19 projects for development of cultural tourism. About EUR 15 million are allocated under the Economic and Social Cohesion for Road Construction component. Under the Tourism – Family Business component of UNDP's Beautiful Bulgaria Project have been allocated about BGN 2 m for 60 projects. EUR 49 m have been negotiated under SAPARD for 103 rural tourism development projects.

Overall these are basically allocations from European funds, but it should be noted they are not always successfully utilized; come contradictions in the selection of projects for financing are also observed.

The national tourist exchange Cultural Tourism 2004 organized at the end of June in Veliko Turnovo will have a positive effect on alternative tourism. The opportunities and problems of Bulgarian cultural tourism development were discussed at the forum. Shortcomings include lack of special sector organization for cultural tourism (overall, Bulgarian entrepreneurs in the area of tourism, the alternative forms included, are well organized – BAAT, BASSET); lack of dialogue between the people engaged in culture and science on one part and the hoteliers and restaurateurs on the other part; lack of good central and local government – entrepreneurs partnership, which means that there is lack of concerted efforts of all people interested in the development of cultural tourism. There is also lack of roads to many interesting and important cultural and historical monuments, the quality of cultural tourism advertising and alternative tourism advertising in general is low, there is also a need to create Internet sites.

Marketing and Advertising

By Decree No. 203/5 August 2004 of the Council of Ministers the Executive Agency for National Tourist Advertising was transformed into **Tourism Agency** at the Minister of Economy. Rules on the structure and organization of the new agency were also adopted; according to these rules agency's functions include: registration, categorization and control; tourist product development; marketing, advertising, information.

Overall, **funds for advertising** the Bulgarian tourist product are insufficient – BGN 2.4 m were initially allocated for 2004, but in early September it was announced at a meeting of the National Tourism Council that another BGN 3 m will be allocated for national tourist advertising in 2004. These funds will allow paying in advance all participations of Bulgaria in the 2005 exchanges and exhibitions, whereby the unsuccessful practice of allocating funds in the last instance will be avoided. The biggest exchanges where Bulgaria will participate are London in November and Berlin and Moscow in the beginning of 2005. MoE has also taken into account the proposals of the non-government organizations in the sector – BATA, BAAT.

Public procurement calls will be published for development of advertising materials and information brochures for the mass as well as for the alternative tourism in Bulgaria. The national tourist advertising is expected to become an element of the integrated advertising strategy for Bulgaria as a good place for investment, business and tourism.

Legislative Framework

Talks about the need to pass an **Act on the Black Sea Coast** have intensified in recent months. The draft law developed by the Ministry of Regional Development and Public Works generated significant disputes and comments. The draft does not provide an answer to a number of questions and offers formulations which, according to experts, are disputable. There are doubts that the draft law will lead to violation of fundamental principles laid down in the constitution such as freedom of economic initiative, equal conditions for economic activity; there is a risk of discriminating investors and owners having intentions to invest in the future; the specific interests and needs of municipalities, particularly of those along the southern Black Sea coast are not taken into account; the act will actually protect against competition those who have already invested and are now operating sites along the Black Sea coast; preliminary analyses and studies of the effect of this act on the subjects concerned have not been made and this is a requirement under the Act on Restricting the Administrative Regulation and Administrative Control of Economic Activity.

It is for such reasons that many experts, representatives of municipal and regional administrations in the Black Sea region seriously doubt the need to pass such act. What is more, public relations with respect to the whole Black Sea coast have been regulated in a number of other acts – the Structure of the Territory Act, the Concessions Act, the Environment Protection Act, the Farm Land Protection Act, the Protected Territories Act, the Forestry Act.

While the good wheat crop contributed to the higher share of agriculture in Bulgaria's GDP and GVA compared to 2003, the tendency of gradual decrease of this share is preserved. Thus in the second quarter this share is 8.5 and 9.8 per cent accordingly, against 8.1 and 9.3 in 2003. This has effect on trade – export of agricultural goods registers considerable increase against the first three months of 2004 as well as against the second quarter of 2003 whereby the positive trade balance for this commodity group is restored.

Condition of the Sector

After harvest end the **wheat crop** is estimated at 3.5–3.8 m t, while the **barley crop** is estimated at over 1 m t. Experts report peak average yields for the last 12 years – 390 and 365 kg per decare of wheat and barley accordingly. The sunflower crop is estimated at 1 m t, and the maize crop is estimated at 1.5 m t. Preliminary estimates show that sunflower and maize yields have doubled against last year. Under these circumstances local market demands will be completely satisfied and export quantities will be provided. The ban on wheat export was lifted since the beginning of July and the market stirred up. About 500 thousand t of grain from the new crop were exported by the end of August; half of this quantity was realized under the duty free quotas for the EU. Following the poor crop of last year and the need to complete the reserves, the conditions for export to the international market are assessed as good, however prices remain unstable. The yield allows for export of not less than 1 m t of wheat and given the high quality one can expect very good realization.

Unlike the international market, the domestic one is in a temporizing condition. Wheat producers insist on higher prices which traders are not ready to pay and consequently no transactions are concluded on the exchanges yet. The State Reserve has already advertised public procurement for purchase of 115 t of bread wheat to supplement the reserves. According to the notice published in the Official Gazette the grain should be from the new crop and should meet certain quality requirements. No price at which the transactions for the individual lots of 5000 t will be concluded is stated. The objective is to prevent the replenishment of state reserves from having effect on the market.

The 2004 good grain crop promoted entrepreneurs' interest in the subsidies from the Agriculture Fund and the crediting against warehouse bills. Grant aid of BGN 29 m and BGN 9 m of low-interest bearing target loans are secured for the autumn campaign of grain producers. The aid is granted for the purchase of quality seeds, pre-sowing fertilization of crops, purchase of diesel fuel, quality seeds production, wheat storage.

The summer was rather cool, with a lot of rain, which predetermined the expected poorer **grapes crop**. The weather delayed grapes ripening and the rain and hails in some regions

compromised the crop quality. The large share of aged and amortized vineyards, as well as the neglected and poorly managed massifs, also contributes to this situation. Investments in planting new massifs were not observed until recently, but these massifs are not yet operational. Prices are expected to remain at last year levels, but there may be differences by regions depending on grapes crop and quality.

The year proved very good for the **rose production**; for the first time in many years the rose oil output reached 1 ton. The purchase price per kilogram of rose blossom reached BGN 1.70–2.20, and the international price per kilogram of rose oil exceeded EUR 4100. The good crop is a result of the favorable weather conditions as well as of the new plantations which already give blossom. While the crop is good, problems in the sector persist – there is lack of rules, unfair competition is spreading, producers are not obliged to determine the quality of rose oil in accredited laboratories. Efforts to find a solution of these problems are made by the **draft Rose Production Act**, which however is not passed by the parliament yet.

Environment for Development

At the end of July the Government decided to reallocate BGN 19 m from Fund Tobacco to **State Fund Agriculture** and to allocate another BGN 10 m as additional subsidy from the budget to support grain producers in the autumn sowing. Thus the average subsidy per decare is now about BGN 10 against BGN 7.50 for last year. It is granted for purchase of quality seeds, pre-sowing fertilization of wheat crops, purchase of diesel fuel for the sowing campaign. Besides State Fund Agriculture grants BGN 9 m in the form of Fund-guaranteed low-interest short-term target loans. The maximum area for which the Fund will grant subsidies to the grain producers is also increased from 5000 to 6000 decares. Additional BGN 1 m are allocated for storage of the 2004 wheat crop. Purchase of grain from producers at market prices for the needs of the State Reserve is also added to the above support for grain producers. The provision of grant aid under the target line for tilling uncultivated private farm land which promotes farmers' initiative to develop additional activities and include neglected areas is also gaining pace. The expanded government support measures for agriculture are related to the increased interest of producers, the agreements with the EU and the reform in Community's Common Agricultural Policy.

In July SFA advertised a second tender for issuing export licenses for export of agricultural products to countries outside the EU in view of getting **export subsidy**. The subsidy is granted to companies exporting poultry meat, milk products, canned fruit and vegetables. The minimum quantities for which one can apply for a license, total quantities for which subsidy will be granted, quality requirements, etc. are specified. Export subsidies are an element of CAP, but Bulgarian producers are

not yet sufficiently aware of the measure and the conditions for its implementation, hence the interest remains moderate.

The set up of **professional organizations of agricultural producers** is an element of EU's common market organization in the agriculture sector which is now gradually implemented in Bulgaria. These organizations will be entrusted to allocate the target funds for agriculture granted following Bulgaria's accession to the EU. While many associations exist in the sector, no organization of this kind has been registered in the three years after the special ordinance was passed. For that reason at the end of August MAF adopted amendments to Ordinance No. 24 whereby the minimum number of members is reduced from 30 to 7 and the annual turnover of the association – from EUR 150 thousand to EUR 100 thousand. The minimum area of arable land and the output volume are also reduced. These amendments are in line with the amended European legislation targeting CAP reform. They are expected to create the necessary conditions to encourage the association of agricultural producers and their preparation for operation in the conditions of an enlarged EU.

A draft law on the veterinary medicine activity was approved in early September in fulfillment of Bulgaria's commitments to the EU. The law transfers the control on the quality of animal products to the production and processing phase and not to the phase of their coming on the market. The new law provides for registration of every producer in the integrated registration system to enable such producer to sell his products to the processing enterprises. Eight European directives on the conditions of animal breeding are transposed. Besides, by the end of 2005 all processing enterprises have to achieve the European production standards guaranteeing products quality. To date over 100 enterprises have fulfilled all requirements of the European directives, over 1000 have been assessed as having potential to satisfy the standards by the end of 2005. Most of the enterprises which do not have the potential to satisfy the requirements are already closed, 74 have been granted permission to operate till 2005 observing the requirements for production of safe foods.

On the insistence of the Bulgarian government and owing to the need to make the adaptation of the processing sector to the high requirements of the European market a major priority, the STAR Committee (a coordinating body to the EU) agreed to restructure some of the funds under **SAPARD**. EUR 135 m are reallocated to measure 02 – processing sector, and measure 03 – rural regions development (EUR 105 m for the first and EUR 30 m for the second measure). Amounts for new slaughterhouses are increased (by EUR 5 m whereby total limit of funds for the purpose reach EUR 25 m) and for fruit and vegetable markets (total limit of EUR 50 m). At the same time the limit of investments for construction of hotels in rural regions is reduced from EUR 500 m to EUR 250 m. The restructuring of the funds from SAPARD is expected to improve the organization

and quality of proposed projects and to enhance the program implementation effect.

With the SAPARD projects approved in July total projects since program start reached 1734, and their total value exceeded EUR 1.3 b. The number of projects for purchase of the necessary modern equipment and for rehabilitation and construction of irrigation systems remains rather high. But increase is also registered in the number of projects for development of vine massifs and areas of perennial plants in relation to the opportunity granted to Bulgaria to increase in the next two years the areas of such plants. The projects for diversification of economic activities (outside rural tourism) are also interesting. These include apiculture, wood processing, bio fuels, aquacultures, essential oil plants processing, horse breeding, etc. The number of rural regions development projects is increasingly higher. Most of these projects are for construction and improvement of water supply, sewerage and street network, as well as for development and improvement of the inter-settlement infrastructure.

At the end of July WTO member states reached a difficult agreement on the current **negotiations on agriculture**. The agreement reached has three aspects: lowering the import duties for agricultural products, cutting down the internal support for producers, eliminating the export subsidies. The general opinion is that while the agreement is very general, it contains the necessary elements allowing for the development of a balanced final document. While the time limits and the specific figures for implementing the agreements reached are rather vague, it is obviously clear to all participants in the negotiations that the restructuring of the national systems for support of agricultural production requires time. Bulgaria's position for smooth cutting down of any form of government support within the transitional periods is in harmony with that of the EU. The lowered internal and export subsidization is at the root of the currently implemented reform of EU's Common Agricultural Policy and it is already laid down in the agreements on Bulgaria's accession. Subsidization within the country is totally underdeveloped and its restriction will not have any negative effect on production. The fact that Bulgarian agriculture does not rely on subsidization may prove an important competitive advantage in the future. The agreement is expected to result in wider opening of agricultural markets and improved export opportunities for Bulgarian agricultural producers.

Work on the implementation of the provisions of the new Regional Development Act continued over the past months; the objective was to make regional planning mechanisms operational. Efforts to strengthen local governments' capacity to develop projects for the successful absorption of EU funds and improve local self-government also continued.

Documents and analyses in this field

The **Methodological Guidelines for Developing Regional Development Strategies (RDS)** were a useful document on regional policy and strategic planning which became available in July 2004. The new Regional Development Act promulgated in February 2004 provides for the development of a number of planning and programmatic documents, including regional strategies and development schemes (NUTS 3 level). The MRDPW-proposed Methodological Guidelines allow regional governors to prepare the required documentation faster and better⁴⁰.

The National Regional Development Program outlines two major types of documents: strategic and programmatic. Strategic planning is provided by two documents: the National Regional Development Strategy and the Regional Development Strategy.

The set of programmatic documents includes the National Operational Program for Regional Development, the Regional Development Plan and the Municipal Development Plan. The Methodological Guidelines for Developing Municipal Development Plans were also made available in September.

The Regional Development Strategy forms the framework for the development of the region and is a strategic document drafted in compliance with the National Regional Development Strategy and closely related to the Regional Development Plan (RDP) and the Municipal Development Plan (MDP). A scheme for the social and economic development of the region that guarantees the protection of the environment will be developed as part of the RDS. The Regional Development Strategy is a component of the strategic planning for regional development; it sets the objectives and priorities for the region's development along with the actions needed to achieve them.

The Regional Development Strategy should comply with several basic principles: it should be long-term; it should have fact-finding value instead of just being informative; it should consolidate facts instead of simply providing reference; it should provide a combination of "bottom-up" and "top-down" methods; it should be applicable to specific sectors and areas of activity; it should be feasible in terms of resources and implementation processes; it should be well-grounded in terms of prior research and expertise; it should be comprehensive in terms of its scope but without getting into too much detail; it should be consistent in terms of its content; it should be open; and it should be discussed with the active participation of local partners.

The development of the Strategy presupposes combining the vertical and horizontal approaches. It must be consistent with the most important principles of regional policy: subsidiarity and decentralization.

The Guidelines also stipulate the key differences between currently existing regional development plans and the regional strategies which should be drafted under the new Regional Development Act. Differences are focused mainly in the level of concretization of activities and the visualization of territorial development. Regional strategies are more general in nature than regional development plans - they form the strategic framework of development; there is no cohesive structure for analysis of the socio-economic development; existing plans do not discuss the issue of coordination and the responsibilities of local and regional structures in the achievement of objectives; some plans discuss the socio-economic environment of constituent municipalities in too much detail (something the RDS does not do). Many of the existing regional plans were adopted without public discussion and wider debate. Therefore existing regional development plans should be brought in line with the requirements of strategic planning and the development of regional development strategies.

The Guidelines describe in detail the stages of developing a strategy and what the content of the RDS must be, thus stipulating how each individual section of this important strategic document should be drafted.

The Methodological Guidelines for Developing Municipal Development Plans were also made available. The document aims to assist municipalities in bringing their existing development plans in line with the requirements of the new Regional Development Act and help them draft the Municipal Development Plans (MDP). The Methodological Guidelines are not compulsory for municipal authorities but they allow for MDP to be brought in line with planning documents at higher levels. Using the Guidelines can ensure the inclusion of planned activities into the National Operational Program for Regional Development - which is a prerequisite for the provision of financial resources for these activities. Financing local projects from external sources will be very difficult in the future if these projects are not part of the municipal development plan adopted with consensus.

The Methodological Guidelines provide for the MDP to be linked to strategic planning and programmatic documents for regional development which are being drafted at the national and regional level and at the "planning region" level; in addition, the Guidelines regulate the timing of activities.⁴¹

⁴⁰ The Methodological Guidelines were approved by Ordinance № ПД-02-14-388/26.07.2004 of the Minister of Regional Development and Public Works and are available on the MRDPW website.

⁴¹ For further detail and the full text please visit: <http://flgr.logincee.org>

The **Assessment of Municipal and District Capacities for the Absorption of the EU Structural and Cohesion Funds** was published in July. The document was prepared on an initiative by the UNDP office in cooperation with the MRDPW. The Report is a summarized assessment of the local and regional capacity and preparedness for the absorption of EUR 2.3 b from the Structural Fund and the Social Cohesion Fund allocated to the country as part of the “financial package” for the three initial post-accession years (2007–2009).

An assessment of the current capacity of Bulgarian regions to absorb the projected financial resources was also prepared. In addition, the document identifies measures that need to be taken to strengthen the absorption potential. Attention is given to some legal and institutional issues existing in this area which need to be promptly solved to create a more favorable environment for the most beneficial use of financial resources. The analysis results allow for several basic conclusions to be drawn on Bulgarian regions' capacity to use the funds:

1. Administrative structures: The report notes that most municipalities and regions have established the necessary structures and conditions for project work; however, most structures are concentrated in larger municipalities.
2. Human resources: A small proportion of municipal and regional staff have benefited from training in project preparation, strategic planning and other related issues.
3. Information/Communication: To a great degree, information channels are already in place; information needs, however, remain highly unsatisfied, particularly as regards procedures.
4. Financial resources: A relatively small share of municipalities and regions are in a position to allocate resources for the co-financing of projects – as few as 28 per cent of municipalities and 4 per cent of regions have such financial capabilities. The main reason most municipalities quote is the limited budget availability.
5. Project capacity. Experience with pre-accession instruments: A relatively limited experience in the absorption of pre-accession funds is noted; over 70 per cent of municipalities never had a project approved while 1/3 have never submitted any project proposals and 1/5 have no project ideas at all.
6. Major difficulties in project development: Limited financial resources for project co-financing, complicated bureaucratic requirements and procedures, short deadlines for project preparation.
7. Project capacity and partnerships: Partnership between municipalities and horizontal links between them are very limited; they do not adequately benefit from opportunities to solve problems jointly and unite their resources.
8. Municipal and regional planning capacity: Municipal plans are mostly formal instead of operational in nature. Municipal planning is perceived as a 'closed' process affecting only the particular municipality; there is no vision on the vertical

and horizontal links within the overall national planning process. Existing regional development plans are too few in number.

9. Training: Training provided so far is general in nature while it should be much more pragmatically-oriented.

Based on the analysis of findings, the report puts forward some important recommendations, which, if put to practice, could improve municipal and regional absorption capacity. Recommendations run in several major aspects:

- Improved information, communication and transparency of procedures. This could be addressed through developing an Information and Communication Strategy and Action Plan. Another recommendation is the launching of a national public information campaign about opportunities provided by EU funds.
- Strengthening the role of local resources and partnerships. This could be achieved by establishing objective criteria for national co-financing.
- Building sustainable municipal policy-making, planning and partnership capacities. This calls for the development of a national capacity-building program to improve the EU funds absorption capacity - which means establishing a unified methodology and monitoring. These measures will lead to a change in attitudes and expectations related to EU funds – it should become clear that these resources "are not given but have to be earned"⁴².

Some good practices in local self-government and EU funds absorption

In September the “Trakia” Regional Association of Municipalities signed a **Cooperation Agreement** with the Greek association “Trakia Polis”. The official signing of a Cooperation Agreement with the Turkish Association of Municipalities “Trakia Kent” will be held in October. The purpose of this trilateral cooperation initiative is to form a common European Region. As regards Greek partners in particular, the intention of “Trakia” Association is to apply for European Union projects jointly while making use of Greece's experience in this field. The trilateral partnership thus established enables participation in cross-border co-operation projects financed under EU programs. At this stage only the general framework of cooperation is being discussed and its concrete parameters will be agreed at future meetings.

“Trakia” Association is a non-governmental organization; it is a voluntary association of municipalities comprising 34 municipalities from 7 regions in the country. It covers approximately 1/3 of Bulgarian population and includes the entire Stara Zagora, Sliven, Yambol and parts of the Burgas, Plovdiv, Haskovo and Kardjali regions. This form of interaction between municipalities is particularly productive because,

⁴² For further details please visit the UNDP website: www.undp.bg

on the one hand, it provides opportunities to advance and strengthen local self-government, while, on the other hand, it enables members to join efforts and potential when applying for funding under EU projects in infrastructure, environmental policy, and capacity strengthening of the local government.

Forums and meetings held in the country play an important role in ensuring successful regional development. The **National Conference on "Public-Private Partnerships in Favor of Local Communities"** held in September was an event of national significance. The forum was organized under the JOBS project jointly with the National Association of Municipalities in the Republic of Bulgaria and was open to all 264 municipalities in the country. It aimed to highlight ways for public-private partnerships to contribute to the successful economic development of Bulgaria's regions. A number of good practices have already been established in the country and these were showcased during the conference. They are an example of how cooperation between businesses and the public sector can lead to accelerated economic development, discovering new sources for development and mobilizing the economic potential of municipalities. The JOBS project model has proven successful in Bulgaria. It is implemented by the Ministry of Labor and Social Policy with support from the UNDP. As part of the project, 37 business centers and incubators have been established in the country and now successfully support local businesses and the start-up of new businesses. The assistance provided to job-generating micro- and small companies at the local level is particularly useful. The project's total budget for the 2000-2006 period is over USD 20 m of which about 19 m provided by the Bulgarian government.

A step towards the improvement of both central and local governance is the forthcoming establishment of **a unified national database of territory, population and resources**—this will be the foundation of e-governance in Bulgaria. Its purpose is to strengthen the required pre-accession information base. The database will be managed by the Council of Ministers; it will become the groundwork for setting up specialized information systems servicing various institutions, incl. local government, and will be used for the exchange of information with the relevant EU and NATO bodies.

The database will be maintained by a single national centre under state control; a proper level of security will be ensured. Information related to property will be publicly available while guaranteeing the security of personal data. An inter-ministerial taskforce has been established to prepare a Program and Action Plan and submit a proposal on establishing the government body that will be in charge of implementing the decision.

Another good example in local self-government is the NAMRB decision to experiment **a new model of joint negotiation on public procurement contracts** by several municipalities. The purpose is to negotiate a higher discount and save on municipal

funds while lowering the corruption pressure at the local level. The first public procurement contract of this type was one for the delivery of cars for municipal officials; it involved 34 small municipalities wishing to purchase one car each. The Association announced that if that first attempt at joint negotiation for supplies and services by several municipalities turns out to be a success, then after 1 October - when the amendments to the Public Procurement Act enter into force - a special unit will be established at the Association to deal with such procedures. The Association's intention is to prepare a similar procurement procedure for computer equipment and later also for transport services, road repairs, general insurance. This practice will probably turn out to be a good option to save funds and lower the corruption pressure at the local level.

THE STATE OF REGULATORY REGIMES APPLIED BY BODIES OF THE CENTRAL AND LOCAL ADMINISTRATION IN BULGARIA

by a Team of the Center for Economic Development

European practices in the area of regulatory reform

The past several years saw a shift in the way regulatory environment issues are addressed in EU countries; an increasing need is experienced to apply efforts towards:

- establishing a new regulatory framework to promote the competitiveness of economies;
- reducing the administrative burden, particularly to SME;
- developing modern technologies and, above all, launching e-government services which dramatically change the way in which citizens and businesses settle their business relations with government and municipal institutions.

Striking a good balance between competition, deregulation and high quality of the regulatory environment is an extremely challenging task. The establishment and development of an efficient regulatory framework in European countries is focused on:

- ongoing consultations with the private sector;
- placing regulatory reform among governments' key priorities;
- reform in public services and public administration to ensure the provision of efficient and high-quality services;
- extensive availability and use of e-government services.

There are several key principles in regulation that European countries generally adhere to:

- adoption of a program for reforms in the regulatory field with clear-cut objectives and implementation deadlines;
- regular review of regulatory regimes to achieve continuity and efficiency;
- transparency and equality for all agents;
- promotion of a policy of competition by eliminating unnecessary barriers.

These principles allow for the basic components of regulatory reform to be put in place – a clear and coherent policy on regulation; the institutionalization of such policy (establishment of specialized institutions); public administration reform and improved quality of services; launching of e-government services.

The overall process of regulatory reform relies on meeting several requirements: a consensus is reached on the need for reforms based on the cooperation between the private sector and the state and the basic parameters of such reforms; regulatory reform is declared a priority of government policy; an administrative or other structure is established which is

assigned with the task to work methodically and consistently on simplifying the regulatory environment.

Reducing the administrative burden is treated as a priority of government policy in most European countries; this priority is respectively institutionalized - specialized units have been established at various levels, with various links of interdependency and competence - all of them, however, have it as their objective to work systematically, incessantly and consistently on enhancing the regulatory environment in their respective countries. Existing structures are quite diverse, for instance: Ireland – National Competitiveness Council; France – Council on Simplification of Administrative Procedures (Conseil d'orientation de la simplification administrative); United Kingdom – Regulatory Impact Unit, Standing Committee on Regulation etc.

There are five fundamental principles of good regulation – needs assessment for existing or proposed new regulations; compliance with EU Directives; establishment of regulations which are transparent and ensure the equal treatment of economic agents; establishment of regulations which are reasonably clear and easy to understand; establishment of regulations that ensure the efficiency of economic activity; establishment of regulations that protect public and business interests and enjoy wide public support.

A number of countries have adopted laws on streamlining and simplifying the regulatory environment.

As can be seen from the issues discussed above, we are dealing with a comprehensive and consistent policy in the area of regulatory environment with the relevant principles, milestones and institutions. These general prerequisites based on European countries' experience in the process of regulation can be used as guidelines in overhauling the regulatory system in Bulgaria.

Current practice in Bulgaria

In the course of the past several years Bulgaria, too, made important steps in upgrading its regulatory regimes and establishing favorable conditions for fair competition, bringing down the number of barriers to start-up business, simplifying the rules, reducing state intervention in economic activity.

To this end, an inter-ministerial Working Group was established by Council of Ministers' Decision № 139 of 12 March 2002; the ASME was appointed to coordinate its work. The expected positive effect from the activity of the Working Group is the simplification of licensing, authorization and registration regimes. About 600 regimes administered at the central level

were subject to review. The proposals of the inter-ministerial working group recommending removal and simplification of the regimes were approved by CoM Decision No. 392 of 7 June 2002. The proposals covered over 300 regimes and envisaged the removal, simplification or preservation in conformity with health and public safety requirements or implementation of certain EU legislative acts. The Decision decreed that 73 regimes be removed and another 119 simplified.

The adoption of amendments to implementing legislation in execution of that Decision is still underway. As of September 2004, 158 regimes are in the process of removal and simplification or have already been removed or simplified and no steps have been taken for the other 34 regimes, i.e. implementation is 82%.⁴³

Another task in the area of regulatory regimes was to prepare a mechanism to introduce a public Register of Regimes thus achieving a considerable simplification of procedures and a smaller number of corruption-generating practices. A database of regulatory regimes was created as part of the Register of Administrative Structures and the Acts of the Executive Bodies; it has been available online since February 2003.⁴⁴ The database contains information on the regimes administered by central and municipal bodies and enables entrepreneurs to receive fast information on regulatory requirements, administrative procedures, documents, required fees for obtaining a license, authorization or registration.

An important step in optimizing the business environment was the drafting and adoption of the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity. This involves the establishment of general principles in enforcing administrative procedures and adjusting current and future regimes to these general principles. The essence of the Act is to regulate generally the relations between merchants and central and local bodies in terms of commencing, conducting and termination of economic activity. The positive effect of this approach would be an improved business environment creating more transparent and simplified rules for the business, common criteria for the introduction of regimes and cost reduction.

The Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity was adopted by the National Assembly on 4 June 2003⁴⁵ and came into force in December, 2003. This law represents a new social contract between business and the government. According to this law, any regime shall be established by a legislative act. It specifies 39 economic activities which require a licensing regime. These are: banking and insurance, pension insurance, some

production, transport and trade activities, foreign trade, external trade in arms, ammunitions and goods of possible double use, manufacturing of compact discs, etc. The Act provides for licensing of medical establishments, trade in drugs, radio and television broadcasting, and communications. Licenses for all types of activities are issued only by a central administrative body.

The key positive aspects of this law are as follows:

- the enforcement of any licensing, registration and authorization regime will only be done by a law;
- the list of economic activities which may be regulated by a licensing regime has been adopted and approved (these activities are 39 in number);
- the preliminary analysis of the impact on the business environment of a proposed piece of legislation is made compulsory;
- the concept of tacit consent is adopted for one-off transactions;
- the "one-stop shop" is introduced
- the administration is obliged to provide detailed and full information on time-limits, payable charges and fees and the methodology used to calculate them; in addition, it is obliged to provide assistance in the filling-in of documents.

The anticipated positive effects of the enforcement of this law are: greater transparency and predictability of the business environment, clearer rules, less corruption. It should be noted, however, that the effect of the law is to be felt in the future. The law was adopted in mid-2003 and a six-month term was envisaged for all government institutions to examine the acts issued by them and correct those which contravene the law. A number of institutions have not yet taken the necessary steps to achieve compliance with the provisions of the law.

A considerable amount of work was done in the course of the past years in the area of regulatory reform; however, it is worth noting that the policy line in this field is not yet adequately focused – it is obvious that efforts on the review and monitoring of regulatory regimes should be an ongoing process; therefore permanent monitoring by a specialized unit is necessary. A possible approach would be to restore the inter-ministerial working group, consisting experts from various agencies, which will be given the statute of a permanent body - it could efficiently manage such activities. Other possible option is to establish a unit under the Council of Ministers or MoE with an advisory body consisting of members of the business community represented by branch associations, and NAMRB representatives. A special role may be assigned to non-governmental organizations providing monitoring and preliminary analyses of the impact of new regimes and legislative changes on business environment and the affected economic agents. Meanwhile, it is necessary to collect and streamline the entire information and results from

⁴³ Ministry of Economy, "Registration, Licensing and Control" Directorate, Short information on the implementation of CoM Decision № 392/2002.

⁴⁴ www.government.bg/ras/

⁴⁵ Official Gazette № 55/17.06.2003.

all project efforts in the area of regulatory regimes - an activity currently implemented by various institutions, including non-governmental. This information should serve as the stepping stone for all subsequent measures in the process of regulatory regimes monitoring, thus ensuring continuity.

Latest developments in the area of regulatory reform

The government continues its active efforts towards the facilitation of regimes at the central and local level. In the spring of 2004 the Ministry of Economy launched a project in the area of administrative reform which is an important step in seeking various options to reduce the number of administrative barriers to businesses. A significant shift in the approach to analyzing and streamlining of regimes was achieved – up until then, the process was initiated by the central administration, and the business community's opinion and requirements were taken into account only in the broadest terms. What is characteristic of the approach used in the project (launched in May 2004) is that the opinion and proposals of entrepreneurs play a leading role in identifying the administration's priority actions. The following were used for preparing the analysis and drafting the concrete proposals: a MoE-sponsored survey held in May among business representatives and consultations with branch associations. Taking into account entrepreneurs' opinion, experts prepared a comprehensive assessment of the state of regimes administered at the central and on municipal level and formulated well-grounded proposals to streamline these regimes.

The objective is to identify businesses' key concerns related to the regulatory environment; the regimes that create the most difficulties and which affect the largest group of entrepreneurs, by seeking the point of view of the affected group, i.e. entrepreneurs and their branch associations. In experts' opinions efforts to streamline regimes must be precisely targeted at these regimes that appear to be most problematic and cause the greatest difficulties. In this way businesses' demands and actual needs can be satisfied to the highest extent; it would also allow for measures to be taken which will result in the tangible improvement of the regulatory environment.

Such an approach could, to a great extent, create conditions to achieve consensus on the priorities in the process of regulatory reform and could be considered as a form of dialogue between the business community and the government on obstacles of administrative nature that must be overcome as a matter of priority.

Another important and novel aspect in the approach is the research into the state of regulatory regimes administered at the municipal level. A detailed description of regimes administered at the local level is being presented for the first time and a picture of these regimes is drawn. A few proposals aimed to enhance some of them are also provided.

The major sources of information used as part of the project implementation include:

- opinion survey among business people carried out in May by Vitosha Research;
- views and proposals by branch associations to streamline regulatory regimes;
- information provided by municipal administrations on regimes administered at the local level;
- legal analysis of regimes;
- expert proposals to streamline the regimes.

Business community's opinion on regulatory regimes in Bulgaria

The logic and structure of the analysis is preconditioned by the business community's views which could be summarized as follows⁴⁶:

- Regardless of the specific activity of each of the surveyed companies and the industry it is active in, all of them have faced problems related to administrative acts regulating their activity.
- Most common in the work of surveyed companies are the registration and authorization regimes and their equivalents (over 80 per cent). Half of the businesses hold some sort of license regulating their activity.
- On average, the greatest number of problematic administrative acts are identified by businesses active in the field of agriculture and forestry while the smallest average number is for the transport and communication industry.
- The practice to use the help of hired consultant companies which take action to get an administrative act issued is much more common when complicated and lengthy administrative procedures are needed, requiring a large number of documents and taking up much time. These are for example: getting registration for a trading outlet, getting planning permission and being issued with a permit to use a building.
- The regimes generating the most difficulties for entrepreneurs are 6 in number and are as follows: sanitary authorization to start operation by HEI; registration to operate a trading outlet; planning permission (building permit), permit for usage as a building; authorization to start operation issued by SVSC; authorization for automobile transportation of passengers and goods. Attention must be focused on streamlining these regimes as a matter of priority.
- There are several major problems identified by businesses when trying to be issued with all types of administrative acts: the lengthy procedure for issuing the document; the large volume of documents and requirements that are

⁴⁶ Business and regulatory regimes, analysis of the results of an opinion survey of Bulgarian business, Report by "Vitosha Research", a public opinion research agency, May 2004.

required for the issue of a single administrative act, and the need to submit documents which are already present in public registers.

- By and large, businesspeople believe that the majority of administrative regimes need to be changed because they create difficulties and take up much time for businesses.
- The desire and proposals for change in these regimes are mostly related to the simplification of bureaucratic procedures and, above all, to the decrease in number and consolidation of the many documents and requirements needed for a company to be issued with an administrative act; the introduction of an efficiently functioning system to service businesses while cutting down on the time and cost involved such as the "one stop shop" services.

Other proposals are related to shortening the procedures and more extended expiry dates for administrative acts. Proposals made by representatives of branch associations run much in the same direction.

The state of regulatory regimes administered at the central level

The review of regulatory regimes administered at the central level includes information provided by the central administration on a total of 322 regimes within the scope of the CoM Decision № 392/2002. The project involved a review of the state of these regimes and an assessment of how far recommendations made by the working group were taken into account; comments and further proposals for streamlining of regimes were also put forth.

The recommendations provided as part of the project are based on research into the opportunities to preserve, simplify or remove regimes currently applied by the administration and are aimed at streamlining the work of law-enforcement bodies. And last but not least they are based on a classification of statutory grounds and comparative analysis of conformity to the requirements established in the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity. The goal of this law is to facilitate and encourage business activity by restricting within publicly justified limits the administrative regulation and administrative control exercised on such activity by central and local government bodies.

The information provided by the central administration covers:

- 51 licensing regimes;
- 220 authorization regimes;
- 51 registration regimes.

Of these, a total of 116 administrative regimes comply with European Directives and international conventions. Recommendations set forth by the working group are classified and summarized in number values in appendices to the core report. A review and conformity assessment was carried out to

test the compliance of these recommendations to the applicable provisions and to the law in order to evaluate the progress made towards the improvement of the business environment in Bulgaria through restricting administrative regulation.

This calls for a general conclusion that a large group of regimes administered at the central level are in compliance with the requirements of valid specialized laws which, for their own part, must be brought in compliance with ARARACEA. Many of the recommendations target the need for establishing a legislative base to regulate the environment for their implementation. In this respect the provisions of Art. 4, Para.2 of ARARACEA will be satisfied; it specifies that all requirements needed to start up and implement a given business activity, as well as the conclusion of each individual transaction or action should be established by law.

The following conclusions and recommendations may be outlined:

- Normative acts applicable to administrative regimes at the central level meet, to a great extent, the requirements of ARARACEA, because in most of them the terms for their implementation are included. In this respect, significant progress has been achieved in the efforts to streamline activities aiming to achieve legal compliance.
- It is possible to streamline the established terms and time-limits which still create difficulties for those affected by them and serve as barriers to business development.
- The procedure for compliance with regulatory regimes through pieces of implementing legislation should be specified.
- The opportunity for arbitrary enforcement of new requirements which contravene legal requirements should be restricted.
- The deadline for reaching a decision should be shortened and the compulsory set of documents required when administering the respective regimes should be reduced to the legally valid minimum.
- Problems arising from the implementation of the Structure of the Territory Act and its implementing legislation are also of material significance. In spite of the fact the law took years to draft and adopt and it is aligned with the acquis, hard-to-solve problems still persist in certain areas. Public opinion surveys show that being issued with a planning permission and certificate for use creates the most difficulties to businesspeople. Due to the paramount importance of legal relationships in the field of investment design and construction, the STA should be given special attention by uniting the efforts of all groups of stakeholders – architects, legal advisors, experts in the administration etc., for the purpose of drawing up specific proposals for amendments to the law.

The state of regulatory regimes administered at the local level

A comprehensive review of regimes applied by the local administration was carried out as part of the initiative by the Ministry of Economy to study the current condition of regulatory regimes on the territory of the Republic of Bulgaria. For this purpose, information from 233 Bulgarian municipalities was reviewed and summarized, including information on the regimes administered at the local level such as terms, procedures and time-limits. An assessment was made from the point of view of conformity to the requirements of the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity. The conclusions should be taken into consideration when drafting proposals for amendments to pieces of legislation applicable to the relevant procedures. Conclusions are based on the analysis of 35 administrative regimes applicable to economic agents at the local level.

The comprehensive analysis of regimes calls for the conclusion that municipal administrations apply mostly registration, verification and certification regimes and, in a limited number of cases, authorization regimes. Many of these are in compliance with the provisions of currently valid special laws which, for their own part, must be brought in compliance with the ARARACEA. It is necessary to regulate the terms for their implementation on a legislative base that would impact the authority of municipal bodies to establish terms and procedures, including time-limits and fees for each specific case, and restrict the administration of the respective regimes through locally adopted regulations. In this respect, the provisions of Art. 4, Para. 2 of ARARACEA will be satisfied; it specifies that all requirements needed to start up and implement a given business activity, as well as the conclusion of each individual transaction or action, should be established by law.

The following conclusions and recommendations may be outlined:

- Normative acts applicable to administrative regimes at the local level do not meet the requirements of ARARACEA because most of these acts do not incorporate the terms for their own implementation. This creates conditions for the random and chaotic enforcement of regulations by municipal councils and subsequently causes problems in applying such regulations.
- At the local level there are differences from the point of view of regulation of the requirements for the administration of individual regimes, which creates various problems.
- Terms and deadlines are being enforced which impede the work of those to whom the relevant norms are addressed and create barriers to business development.
- The terms for the administration of regimes at the local level should be established by law – therefore amendments to the legislation should be initiated. The authority of local

parliaments to adopt regulations which stipulate terms and time-limits less favorable than provided by law should be restricted.

- The procedure for compliance with regulatory regimes through pieces of implementing legislation should be specified.
- Currently, no legally established general guidelines are in place to be implemented by local government in regulating the concrete requirements to the addressees of the respective normative acts. The establishment of specific terms for the application of administrative regimes will ensure that no terms for application of the respective norms will be established at the local level which stipulate stricter or more restrictive terms than those provided for by law.
- The opportunity for arbitrary establishment of new requirements which contravene legal requirements should be restricted.
- The deadline for reaching a decision should be shortened and the compulsory set of documents required when administering the respective regimes should be reduced to the legally valid minimum.
- At the local level, changes should be introduced to the qualification of administrative regimes – currently there is no compliance with the requirements of ARARACEA in this respect. Municipalities implement and qualify individual regimes in a number of ways, which is in contradiction with the law. The practice of regulating individual procedures through various acts – orders, resolutions, ordinances, internal regulations – should also be stopped.

There are several regulatory regimes creating the most barriers to businesses in Bulgaria: sanitary authorization to start operation by HEI; registration to operate a trading outlet; planning permission /building permit/; permit to use a building; authorization to start operation issued by SVSC; authorization for automobile transportation of passengers and goods. These are the regimes that must be simplified as a matter of priority.

Key recommendations to improve the performance of the central and municipal administrations

In spite of the action to simplify and remove some regulatory regimes, the difficulties suffered by the business when applying them still persist. The systematizing of regulatory regimes, the removal of contradictions between different normative documents and the improved coordination and contact between institutions will make their implementation more efficient and will reduce barriers to businesses. The future organization of the process to improve the administrative environment for businesses must include, as a mandatory prerequisite, the fast introduction of modern communication tools in administrative services which would enable businesses to have computerized access to administrative documents.

The review of applicable regimes outlines several basic aspects in improving administrative performance. A principal recommendation is to establish a comprehensive and consistent policy in the area of regulatory reform and make it a government priority. This could be achieved by developing a concrete program and schedule for its implementation. The second important aspect which could guarantee the success of such a reform could be the establishment of a specialized institution which will perform regular monitoring on regulatory regimes, prepare preliminary analyses on regimes' impact on the business environment in the country, draft well-grounded proposals for the simplification of individual regimes.

The remaining proposals are related to:

- Ensuring unhindered access to information on concrete services provided by the administration, both central and municipal.
- Ensuring the necessary openness in providing services, and the legal grounds for these services, including related terms, time limits and fees.
- Producing a uniform format for the required forms and applications needed for the relevant authorization and registration procedures (this recommendation is of special significance when starting up a new business).
- Introduce a single identification number (especially when starting up a new business).
- Introducing time limits for processing of applications for company registration.
- Providing forms and applications to interested parties free-of-charge.
- Taking measures to eliminate the duplication of information, documents and forms collected by public administration, including by introducing integrated database.
- Ensuring the maintenance and further improvement of the existing public register by administering applicable regimes in order to assist citizens taking steps to start up a small or medium-sized company, including information on the necessary documentation, time limits and registration fees, respectively the issuing authorizations.
- Wider availability of "one stop shop" services.
- Continuing the process of decentralization and transfer of more responsibility to local authorities in administering regulatory regimes, particularly with respect to small and medium-sized businesses; aligning individual laws, development of active public-private partnerships to improve the business environment at the local level.
- Maintaining a list of applicable regimes by the municipal administration in order to assist citizens taking steps to start-up a small or medium-sized company, including information on the necessary documentation, time limits and registration fees, respectively the issuing of authorizations.
- Active use of "good practices" of interaction between the administration and citizens applied by individual

municipalities. This concerns municipal service centers enabling citizens to receive both information and services at the same location. These centers keep service catalogues where citizens can be given all necessary information about the documents they need to produce, the fee they have to pay for the respective service and how much time it would take to be provided with the service. Such a practice would also have anti-corruption effect due to the elimination of direct contact between officials in respective departments. The purpose is not to restrict or cut off access to the administration but to reduce the number of citizens to only those who genuinely have a specific problem that cannot be solved and calls for specific intervention.

- Wider use of the opportunities provided by e-government. The development of system for remote access to the document flow via the Internet and though the use of information technology as a whole also creates undisputed benefits for the central administration and municipalities having the necessary financial resources.
- Establishing, as a matter of priority, of working groups involving experts from the respective institutions to discuss and propose specific changes in the regulatory framework aimed to simplify the regimes that create the most difficulties to businesses: sanitary authorization to start operation by HEI; registration to operate a trading outlet; planning permission /building permit/; permit to use a building; permit to start operation issued by SVSC; authorization for automobile transportation of passengers and goods.

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Economic dynamics														
Industry														
Industrial production, volume index, previous month =100, %														
2004	85.4	105.8	113.2	89.7	100.5	111.9	98.1							
2003	86.5	96.7	116.7	91.8	94.6	111.8	103.1	93.7	109.0	102.2	99.5	112.6	-	-
Industrial production, volume index, corresponding month of the previous year = 100, %														
2004	112.7	120.6	117.8	114.2	121.3	121.5	115.6							
2003	115.4	115.4	123.4	111.9	109.6	115.4	113.0	110.3	115.9	117.9	111.3	123.5	-	-
Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %														
2004	116.1	118.4	117.8	116.9	117.8	117.9	117.6							
2003	115.4	115.4	118.2	116.4	115.0	115.4	115.0	114.4	114.5	114.8	114.5	115.2	-	-
Industrial sales, total, volume index, previous month =100, %														
2004	84.2	110.1	114.7	93.6	97.3	115.6	101.2							
2003	86.2	96.8	119.6	92.6	98.5	108.8	102.5	93.9	106.3	103.4	98.2	111.0	-	-
Industrial sales, total, corresponding month of the previous year = 100, %														
2004	111.4	124.1	119.1	120.4	118.9	126.4	124.8							
2003	117.7	116.4	130.4	111.3	117.8	118.3	113.4	111.4	116.3	121.5	114.4	121.3	-	-
Industrial sales, total, from the beginning of the year, volume index, corresponding period of the previous year = 100, %														
2004	111.4	117.6	118.1	118.7	118.8	120.1	120.9							
2003	117.8	117.1	121.6	118.8	118.6	118.6	117.7	116.9	116.8	117.3	117.0	117.4	-	-
Domestic trade														
Trade and repairing activities, total, net receipts from sales, volume index, previous month =100, %														
2004	82.2	106.1	102.4	99.4	100.4	104.3	107.1							
2003	71.0	102.7	107.1	101.7	102.6	102.9	106.5	98.2	104.2	102.7	96.8	114.4	-	-
Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, previous month =100, %														
2004	79.7	107.4	107.6	105.6	95.4	109.2	106.0							
2003	76.7	98.0	107.3	102.7	103.4	107.0	105.9	100.1	102.8	105.2	99.2	108.1	-	-
Wholesale and commission trade, net receipts from sales, volume index, previous month =100, %														
2004	83.9	106.7	100.7	97.9	100.1	103.6	108.0							
2003	70.2	104.1	106.7	101.2	102.2	102.2	107.1	97.3	104.8	102.3	96.4	114.7	-	-
Retail trade, repair of personal and household goods, net receipts from sales, volume index, previous month =100, %														
2004	75.1	101.5	109.5	103.0	106.1	104.6	103.2							
2003	71.0	98.9	109.4	104.1	104.3	103.4	103.7	101.1	102.5	103.0	96.9	117.4	-	-
Trade and repairing activities, total, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2004	114.1	114.4	112.8	112.5	110.0	112.2	113.0							
2003	106.1	107.2	108.1	110.0	110.1	108.0	107.2	104.6	105.7	104.9	102.4	105.8	-	-

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2004	111.9	111.3	112.3	121.9	114.7	119.2	119.8							
2003	103.5	98.8	100.6	101.2	102.5	104.1	103.8	102.3	103.1	103.9	101.5	105.2	-	-
Wholesale and commission trade, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2004	114.5	114.9	113.0	111.4	108.9	110.9	112.0							
2003	107.5	109.5	109.8	112.0	112.2	109.0	107.7	104.6	105.8	104.5	101.7	105.5	-	-
Retail trade, repair of personal and household goods, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2004	113.1	113.9	111.5	112.1	113.0	114.1	113.6							
2003	102.0	102.1	104.4	106.4	105.5	105.9	106.9	106.2	106.9	108.1	106.3	108.0	-	-
Trade and repairing activities, total, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2004	114.1	114.2	113.6	113.3	112.6	112.5	112.6							
2003	106.1	107.8	108.0	108.7	109.0	108.8	108.5	108.0	107.7	107.4	106.9	106.7	-	-
Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2004	111.9	111.4	111.7	114.3	114.4	115.3	116.0							
2003	103.5	101.5	101.2	101.3	101.6	102.1	102.3	102.3	102.4	102.6	102.5	102.8	-	-
Wholesale and commission trade, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2004	114.5	114.7	114.0	113.3	112.4	112.1	112.1							
2003	107.5	109.7	110.0	110.7	111.0	110.7	110.2	109.4	108.9	108.4	107.7	107.5	-	-
Retail trade, repair of personal and household goods, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2004	113.1	113.5	112.6	112.4	112.6	112.8	113.0							
2003	102.0	102.6	103.3	104.0	104.3	104.6	105.0	105.2	105.4	105.7	105.7	106.0	-	-
Inflation														
Inflation (Consumer price index - 100), previous month =100, %														
2004	1.4	0.3	-0.1	0.3	0.0	-1.8	1.2	-0.4						
2003	0.6	0.1	0.4	0.3	-0.6	-2.2	0.9	0.8	0.9	0.7	1.8	1.8	-	-
Inflation (Consumer price index - 100), December of the previous year = 100, %														
2004	1.4	1.7	1.7	1.9	2.0	0.2	1.4	0.9						
2003	0.6	0.8	1.2	1.5	0.8	-1.4	-0.5	0.3	1.2	1.9	3.8	5.6	-	-
Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %														
2004	6.4	6.6	6.2	6.1	6.8	7.3	7.6	6.3					6.4	6.7
2003	1.7	0.2	-0.2	0.3	1.7	1.3	2.0	3.5	3.6	3.3	5.1	5.6	0.6	1.1
Employment and unemployment														
Unemployed persons registered, total, end of the period, number														
2004	537 137	527 258	507 508	487 814	466 717	452 428	446 784	442 190					507 508	452 428
2003	646 757	611 727	581 350	552 068	528 718	506 424	489 343	480 881	472 614	476 326	489 618	500 664	581 350	506 424

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, %														
2004	14.5	14.2	13.7	13.2	12.6	12.2	12.1	11.9					13.7	12.2
2003	17.5	16.5	15.7	14.9	14.3	13.7	13.2	13.0	12.8	12.9	13.2	13.5	15.7	13.7
Newly opened vacant jobs, for the period, number														
2004	3 286	4 772	5 050	3 538	4 090	4 571	4 085						5 050	4 571
2003	1 759	2 024	2 136	2 480	2 349	6 076	3 890	2 782	2 804	3 365	3 516	3 999	2 136	6 076
Employed person, total, end of the period, number														
2004	2 077 939	2 097 911	2 118 484	2 148 407	2 165 004	2 180 746							2 118 484	2 180 746
2003	1 946 834	1 991 623	2 016 828	2 043 764	2 054 972	2 068 694	2 075 881	2 067 291	2 063 429	2 050 282	2 034 033	2 005 369	2 016 828	2 068 694
Employed person, public sector, end of the period, number														
2004	751 581	759 430	766 602	767 933	770 037	770 573							766 602	770 573
2003	730 873	757 271	765 688	771 192	771 746	775 281	778 647	776 774	778 293	772 629	768 505	758 795	765 688	775 281
Employed person, private sector, end of the period, number														
2004	1 326 358	1 338 481	1 351 882	1 380 474	1 394 967	1 410 173							1 351 882	1 410 173
2003	1 215 961	1 234 352	1 251 140	1 272 572	1 283 226	1 293 413	1 297 234	1 290 517	1 285 136	1 277 653	1 265 528	1 246 574	1 251 140	1 293 413
Fiscal review														
State budget														
Revenues of the Consolidated State Budget, total, BGN million														
2004	1 126.0	2 110.6	3 636.8	5 097.6	6 375.6	7 646.9	8 996.5						3 636.8	7 646.9
2003	1 029.2	1 944.8	3 220.6	4 631.2	5 813.3	6 830.5	8 054.1	9 158.9	10 311.4	11 573.2	12 657.0	14 072.0	3 220.6	6 830.5
Expenditures of the Consolidated State Budget, total, BGN million														
2004	1 152.7	2 260.2	3 408.4	4 568.7	5 665.8	6 769.3	8 019.8						3 408.4	6 769.3
2003	1 130.6	2 105.4	3 109.8	4 221.5	5 195.0	6 203.4	7 402.7	8 429.7	9 463.7	10 602.5	11 758.1	14 071.1	3 109.8	6 203.4
Consolidated State Budget deficit (-) / surplus (+), BGN million														
2004	-26.7	-149.5	228.4	528.9	709.7	877.6	976.7						228.4	877.6
2003	-101.5	-160.6	110.8	409.7	618.3	627.1	651.4	729.2	847.8	970.7	898.9	0.9	110.8	627.1
Revenues of the Republican Budget, total, BGN million														
2004	777.1	1 368.7	2 343.4	3 368.2	4 241.3	5 098.0	5 912.6						2 343.4	5 098.0
2003	651.3	908.4	1 937.0	2 878.1	3 626.4	4 221.2	4 985.2	5 637.7	6 279.0	7 051.8	7 684.9	8 441.6	1 937.0	4 221.2
Expenditures of the Republican Budget, total, BGN million														
2004	841.2	1 531.5	2 222.5	2 963.0	3 640.1	4 315.5	5 134.6						2 222.5	4 315.5
2003	737.0	1 195.6	1 846.2	2 594.1	3 016.6	3 639.2	4 372.7	4 979.0	5 520.4	6 200.7	6 952.7	8 552.2	1 846.2	3 639.2
Republican Budget cash deficit (-) / surplus (+), BGN million														
2004	-64.0	-162.8	120.9	405.3	601.2	782.4	778.0						120.9	782.4
2003	-85.7	-287.2	90.8	284.0	609.7	582.0	612.4	658.7	758.5	851.1	732.2	110.6	90.8	582.0

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Government and government guaranteed debt, BGN million														
2004	16 731.7	16 852.8	17 032.7	17 332.8	17 187.1	17 198.8	16 089.2						17 032.7	17 198.8
2003	17 547.9	17 638.7	17 560.2	17 679.7	17 062.1	17 364.8	17 466.7	17 858.3	17 194.7	17 140.1	16 930.8	16 509.7	17 560.2	17 364.8
Domestic government and government guaranteed debt, BGN million														
2004	2 331.3	2 397.3	2 425.6	2 462.3	2 475.3	2 494.5	2 494.7						2 425.6	2 494.5
2003	2 113.5	2 207.4	2 290.7	2 246.2	2 225.5	2 233.9	2 215.4	2 236.5	2 218.1	2 193.7	2 248.4	2 241.2	2 290.7	2 233.9
Foreign government and government guaranteed debt, BGN million														
2004	14 400.4	14 455.5	14 607.1	14 870.4	14 711.9	14 704.3	13 594.6						14 607.1	14 704.3
2003	15 434.4	15 431.3	15 269.8	15 433.7	14 836.3	15 131.1	15 251.2	15 621.8	14 976.6	14 946.6	14 683.4	14 268.6	15 269.8	15 131.1
Government and government guaranteed debt, ratio to the annual GDP, %														
2004	44.1	44.4	44.8	45.6	45.2	45.3	42.4						44.8	45.3
2003	49.7	50.0	49.8	50.1	48.4	49.2	49.5	50.6	48.7	48.6	48.0	47.8	49.8	49.2
Domestic government and government guaranteed debt, ratio to the annual GDP, %														
2004	6.1	6.3	6.4	6.5	6.5	6.6	6.6						6.4	6.6
2003	6.0	6.3	6.5	6.4	6.3	6.3	6.3	6.3	6.3	6.2	6.4	6.5	6.5	6.3
Foreign government and government guaranteed debt, ratio to the annual GDP, %														
2004	37.9	38.1	38.5	39.2	38.7	38.7	35.8						38.5	38.7
2003	43.7	43.7	43.3	43.7	42.0	42.9	43.2	44.3	42.4	42.4	41.6	41.3	43.3	42.9
Domestic government debt, total, BGN million														
2004	2 331.3	2 397.2	2 425.7	2 462.3	2 475.3	2 494.5	2 494.7						2 425.7	2 494.5
2003	2 111.6	2 205.8	2 289.4	2 245.3	2 225.1	2 233.9	2 215.5	2 236.5	2 218.2	2 193.6	2 248.4	2 241.1	2 289.4	2 233.9
Debt on Government Securities issued for budget deficit financing, BGN million														
2004	1 822.7	1 889.3	1 914.9	1 949.0	1 967.8	1 986.8	1 985.9						1 914.9	1 986.8
2003	1 515.4	1 608.5	1 696.0	1 658.9	1 658.5	1 658.2	1 637.7	1 652.5	1 653.9	1 633.2	1 696.7	1 703.9	1 696.0	1 658.2
Debt on Government Securities issued for structural reform, BGN million														
2004	508.6	508.0	510.8	513.3	507.4	507.6	508.9						510.8	507.6
2003	596.2	597.2	593.4	586.4	566.6	575.7	577.7	584.0	564.3	560.4	551.6	537.2	593.4	575.7
Domestic government guarantees, BGN million														
2004	0.0	0.0	0.0	0.0	0.0	0.0	0.0						0.0	0.0
2003	1.8	1.5	1.2	0.9	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.2	0.0
Foreign government debt, USD million														
2004	8 620.0	8 635.2	8 587.7	8 545.4	8 621.3	8 587.6	7 815.4						8 587.7	8 587.6
2003	8 109.3	8 091.6	8 090.0	8 355.8	8 535.8	8 414.6	8 372.2	8 284.1	8 461.0	8 417.2	8 530.4	8 718.6	8 090.0	8 414.6
Foreign government guaranteed debt, USD million														
2004	498.1	542.9	541.8	538.0	554.2	550.7	552.7						541.8	550.7
2003	426.3	415.3	416.0	427.8	432.0	425.8	453.4	443.6	461.3	464.3	473.5	495.5	416.0	425.8

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)

Foreign economic relations and foreign investments														
Balance of Payments														
Current account, million USD														
2004	-286.9	-158.9	-166.3	-265.7	-247.5	-35.8	33.1	146.1	17.1	-225.9	-316.0	-328.4	-612.1	-549.0
2003	-164.9	-156.0	-93.6	-388.3	-222.7	33.3							-414.5	-577.7
Trade balance, (FOB), million USD														
2004	-195.0	-183.8	-256.5	-320.4	-369.8	-264.0							-635.3	-954.2
2003	-71.3	-121.3	-117.5	-267.0	-287.3	-159.2	-207.7	-159.1	-148.7	-249.6	-321.9	-363.0	-310.1	-713.5
Exports (FOB), million USD														
2004	631.4	736.1	779.5	715.7	721.1	844.5							2 147.0	2 281.3
2003	544.2	538.7	642.9	570.6	568.0	657.0	717.6	618.1	651.7	677.0	634.3	618.4	1 725.8	1 795.6
Imports (FOB), million USD														
2004	826.4	919.9	1036.0	1036.1	1090.9	1108.5							2 782.3	3 235.5
2003	615.5	660.0	760.4	837.6	855.4	816.2	925.4	777.2	800.4	926.6	956.3	981.4	2 035.9	2 509.2
Services, net, million USD														
2004	-20.8	1.7	-7.5	-50.5	82.8	204.1							-26.6	236.4
2003	-21.7	-14.4	-24.5	-35.0	33.0	169.3	237.4	237.7	124.8	-21.0	-45.5	-39.7	-60.6	167.3
Income, net, million USD														
2004	-131.4	-30.7	-8.2	7.1	-25.4	-22.9							-170.3	-41.2
2003	-113.0	-48.1	-19.6	-132.9	-13.4	-27.0	-61.4	-4.8	-39.2	-4.5	-2.3	-18.5	-180.7	-173.3
Current transfers, net, million USD														
2004	60.3	53.8	105.9	98.1	64.9	47.0							220.0	210.0
2003	41.1	27.8	67.9	46.6	45.1	50.3	64.8	72.3	80.1	49.3	53.7	92.8	136.8	142.0
Capital account, million USD														
2004	0.0	0.0	0.0	0.0	0.0	0.0							0.0	0.0
2003	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Financial account, million USD														
2004	-23.2	495.3	294.0	71.4	460.9	500.6							766.1	1 032.9
2003	-9.0	81.4	120.0	502.2	221.7	122.1	-51.1	50.3	80.9	473.6	163.8	97.1	192.4	846.0
Direct investment abroad, million USD														
2004	-6.0	-1.4	-9.5	-0.8	-1.2	-1.0							-16.9	-3.0
2003	-0.5	-0.4	-1.6	-2.6	0.7	-2.2	-1.9	-4.8	-2.0	-2.9	-0.5	-3.0	-2.5	-4.1
Direct investment in Bulgaria, million USD														
2004	146.9	157.2	134.1	38.5	118.9	603.6							438.2	761.0
2003	86.5	65.5	127.2	149.8	190.3	104.5	163.9	74.6	74.5	326.4	-1.5	57.7	279.2	444.6

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Portfolio investment assets, million USD														
2004	-64.4	-17.2	36.5	-71.9	27.6	28.2							-45.1	-16.1
2003	13.0	10.0	-19.9	10.5	86.5	-36.6	-87.2	-55.3	28.2	-36.7	24.7	-10.1	3.1	60.4
Portfolio investment liabilities, million USD														
2004	-106.2	-48.9	43.1	-15.7	8.1	125.0							-112.0	117.4
2003	-32.0	-3.3	-29.8	0.4	30.2	-1.4	-87.9	-16.1	10.2	-14.8	5.6	4.4	-65.1	29.2
Other investment assets, million USD														
2004	-125.6	146.2	-69.4	97.8	106.4	-426.9							-48.8	-222.7
2003	-15.1	34.7	-60.0	256.7	-140.0	-36.4	-47.2	96.4	-145.6	163.5	88.9	-48.3	-40.4	80.3
Other investment liabilities, million USD														
2004	132.1	259.5	159.3	23.4	201.2	171.6							550.9	396.2
2003	-60.8	-25.0	104.2	87.4	54.1	94.3	9.1	-44.5	115.6	38.1	46.7	96.4	18.4	235.8
Net Errors and Omissions (BP), million USD														
2004	-72.0	-193.6	75.2	269.0	146.9	33.4							-190.4	449.3
2003	-125.9	119.7	56.0	61.1	105.9	-87.5	16.4	-76.7	-23.2	83.4	260.7	156.0	49.8	79.5
Overall balance (BP), million USD														
2004	-382.1	142.8	202.9	74.6	360.4	498.3							-36.4	933.3
2003	-299.8	45.1	82.3	175.1	104.9	67.8	-1.6	119.5	74.7	331.1	108.4	-75.4	-172.4	347.8
Reserves and Related Items, million USD														
2004	382.1	-142.8	-202.9	-74.6	-360.4	-498.3							36.4	-933.3
2003	299.8	-45.1	-82.3	-175.1	-104.9	-67.8	1.6	-119.5	-74.7	-331.1	-108.4	75.4	172.4	-347.8
Finance														
Financial indicators														
Exchange rate BGN / USD, average for the period														
2004	1.549	1.546	1.594	1.633	1.631	1.611	1.594	1.606					1.564	1.625
2003	1.841	1.815	1.810	1.803	1.683	1.677	1.720	1.756	1.745	1.672	1.671	1.593	1.823	1.721
Exchange rate BGN / USD, end of the period														
2004	1.579	1.575	1.599	1.637	1.603	1.609	1.624	1.614					1.600	1.609
2003	1.808	1.813	1.795	1.757	1.654	1.711	1.728	1.789	1.678	1.682	1.630	1.548	1.795	1.712
Basic interest rate, effective annual, average for the period														
2004	2.79	2.49	2.41	2.55	2.83	3.78	2.44						2.56	3.05
2003	3.23	2.5	2.53	2.57	2.95	2.89	2.52	2.53	2.57	2.59	2.6	2.67	2.75	2.80
Money (M1), BGN million														
2004	7 788.4	7 852.5	7 835.1	7 987.2	8 035.7	8 422.3	8 735.8						7 835.1	8 422.3
2003	6 291.4	6 376.6	6 274.3	6 434.6	6 559.6	6 834.4	7 110.4	7 314.3	7 416.4	7 421.7	7 376.6	8 029.9	6 274.3	6 834.4

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)														
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Money (M2), BGN million														
2004	16 439.0	16 655.3	16 678.5	17 081.5	17 270.3	18 032.9	18 292.6						16 678.5	18 032.9
2003	13 550.9	13 722.5	13 541.5	13 762.2	13 765.6	14 197.2	14 623.8	15 045.6	15 073.2	15 698.1	15 604.7	16 464.7	13 541.5	14 197.2
International reserves of BNB, BGN million														
2004	9 842.2	10 113.2	10 517.3	10 628.1	11 190.4	11 975.7	11 056.5						10 517.3	11 975.7
2003	8 364.0	8 473.7	8 603.5	9 234.1	9 316.5	9 452.2	9 518.5	9 800.5	9 882.7	10 414.2	10 557.7	10 383.6	8 603.5	9 452.2
Fiscal reserves at the Issue Department of BNB, BGN million														
2004	3 138.4	3 146.7	3 503.2	3 822.5	4 203.8	4 802.9	3 663.0						3 503.2	4 802.9
2003	2 793.2	2 803.8	3 027.5	3 632.7	3 873.1	3 747.4	3 766.3	3 767.3	3 831.5	3 970.8	4 176.6	3 280.1	3 027.5	3 747.4
Banking system														
Claims on credits granted by the Commercial Banks, total, BGN thousand														
2004	9565122 ¹⁾	9 848 840	10 247 405	10 659 517	11 008 716	11 309 097	11 877 533						10 247 405	11 309 097
2003	6 444 818	6 563 130	6 816 766	7 167 024	7 424 452	7 727 590	7 866 307	8 171 994	8 471 157	8 904 325	9 114 301	9 454 164	6 816 766	7 727 590
Credits to Resident Sector, total														
2004	9 465 473	9 747 743	10 131 312	10 545 411	10 904 864	11 189 803	11 754 355						10 131 312	11 189 803
2003	6 356 088	6 489 721	6 745 467	7 094 504	7 355 881	7 657 439	7 797 284	8 092 008	8 391 057	8 832 873	9 044 229	9 352 878	6 745 467	7 657 439
Credits to Government Sector														
2004	24 891	27 795	26 973	26 451	26 628	28 026	28 586						26 973	28 026
2003	8 673	8 947	9 494	9 380	9 406	9 561	11 924	13 394	19 928	21 667	22 168	24 635	9 494	9 561
Credits to Non-government Sector														
2004	9 440 582	9 719 596	10 104 001	10 518 659	10 877 937	11 161 514	11 720 617						10 104 001	11 161 514
2003	6 291 902	6 444 260	6 662 763	7 014 528	7 280 799	7 603 463	7 727 111	8 030 421	8 325 688	8 751 119	8 977 126	9 303 120	6 662 763	7 603 463
Credits to Non-financial Public Corporations														
2004	-	245 972	231 880	232 625	244 408	243 272	226 689						231 880	243 272
2003	219 215	229 954	235 631	246 234	245 746	231 489	245 251	237 021	230 292	213 420	217 489	234 230	235 631	231 489
Credits to Non-financial Private Corporations														
2004	6785654 ²⁾	6 685 783	6 932 080	7 194 675	7 378 415	7 452 693	7 840 566						6 932 080	7 452 693
2003	4 715 900	4 800 569	4 949 708	5 202 209	5 377 904	5 604 204	5 575 897	5 774 664	5 956 901	6 287 344	6 412 770	6 641 717	4 949 708	5 604 204
Credits to Households and NPISH														
2004	2 530 436	2 655 236	2 802 335	2 950 438	3 107 317	3 302 537	3 487 977						2 802 335	3 302 537
2003	1 260 492	1 300 531	1 355 108	1 438 127	1 532 501	1 645 779	1 758 072	1 853 587	1 933 809	2 035 462	2 116 719	2 201 298	1 355 108	1 645 779
Credits to Non-bank Financial Institutions														
2004	124 492	132 605	137 706	140 921	147 797	163 012	165 385						137 706	163 012
2003	96 295	113 206	122 316	127 958	124 648	121 991	147 891	165 149	204 686	214 893	230 148	225 875	122 316	121 991

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Credits to Monetary Financial Institutions														
2004	-	352	338	301	299	263	5 152						338	263
2003	55 513	36 514	73 210	70 596	65 676	44 415	58 249	48 193	45 441	60 087	44 935	25 123	73 210	44 415
Credits to Non-resident Sector														
2004	99 649	101 097	116 093	114 106	103 852	119 294	123 178						116 093	119 294
2003	88 730	73 409	71 299	72 520	68 571	70 151	69 023	79 986	80 100	71 452	70 072	101 286	71 299	70 151
Total assets, end of the period, BGN thousand														
2004	17 530 661	18 005 393	18 756 066	19 144 405	19 229 222	20 096 015	20 651 822						18 756 066	20 096 015
2003	14 470 798	14 527 980	14 976 602	14 754 441	14 752 332	15 359 751	15 706 435	16 019 647	16 386 230	16 621 238	16 608 301	17 323 643	14 976 602	15 359 751
Total liabilities, end of the period, BGN thousand														
2004	15 198 323	15 634 800	16 340 560	16 727 099	16 843 176	17 660 577	18 158 670						16 340 560	17 660 577
2003	12 413 277	12 474 347	12 882 639	12 702 089	12 694 628	13 252 494	13 584 220	13 870 342	14 218 293	14 410 754	14 364 457	15 042 658	12 882 639	13 252 494
Interest revenues, BGN thousand														
2004	96 863	194 892	299 962	406 956	519 732	637 944	755 537						299 962	637 944
2003	74 730	145 393	223 314	302 382	385 403	465 864	550 315	636 814	724 416	816 202	908 081	1 012 487	223 314	465 864
Current profit/loss, BGN thousand														
2004	41 497	78 677	114 157	132 792	169 150	224 081	257 720						114 157	224 081
2003	98 482	122 770	125 420	148 232	180 278	218 487	242 268	266 588	293 663	322 514	355 375	379 817	125 420	218 487
Social policy and industrial relations														
Wage&Salary ³⁾														
Average Monthly Wage&Salary of employees under labor contract, total, nominal, BGN														
2004	279	278	292	289	296	290	276	273	286	276	286	302	272	292
2003	270	265	280	272	280	274	276	273	286	276	286	302	272	275
Average Monthly Wage&Salary of employees under labor contract, public sector, nominal, BGN														
2004	327	321	350	335	361	343	326	324	352	326	344	368	333	346
2003	308	299	325	318	340	327	326	324	352	326	344	368	311	328
Average Monthly Wage&Salary of employees under labor contract, private sector, nominal, BGN														
2004	251	253	259	262	259	260	244	242	245	245	249	260	254	260
2003	238	234	242	244	242	241	244	242	245	245	249	260	238	242
Real Average Monthly Wage&Salary of employees under labor contract, total, growth, corresponding period of the previous year =100, %														
2004	-2.9	-1.6	-1.8	0.1	-1.0	-1.3	1.3	-0.5	1.4	-1.5	0.1	1.4	-2.1	-0.8
2003	5.7	4.9	5.8	3.6	2.3	2.1	1.3	-0.5	1.4	-1.5	0.1	1.4	5.5	2.7
Real Average Monthly Wage&Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %														
2004	-0.2	0.7	1.4	-0.8	-0.6	-2.2	3.4	0.3	3.5	-1.7	2.6	4.9	0.6	-1.2
2003	7.3	4.7	7.1	6.4	5.1	3.8	3.4	0.3	3.5	-1.7	2.6	4.9	6.4	5.1

ANNEX 1: MAIN INDICATORS SINCE THE BEGINNING OF THE YEAR

(Continued and end)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Real Average Monthly Wage&Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, %														
2004	-0.9	1.4	0.8	1.2	0.2	0.6							0.4	0.6
2003	2.1	1.9	1.8	2.3	0.8	1.3	-0.4	-0.9	-0.3	-1.2	-1.7	-1.2	2.0	1.4
Income and consumption of the households ³⁾														
Total income, monthly, average per person, nominal, BGN														
2004	141.3	135.6	148.7	157.4	161.7	161.9	183.8						141.8	160.3
2003	128.8	122.4	135.8	142.4	146.6	152.3	157.2	157.0	157.0	156.2	162.1	210.6	129.0	147.1
Cash income, monthly, average per person, nominal, BGN														
2004	136.4	131.9	143.0	145.0	147.3	150.5	154.5						137.1	147.6
2003	124.5	118.3	130.2	132.5	134.2	139.1	142.2	142.0	142.2	140.7	137.2	175.3	124.3	135.3
Total expenditure, monthly, average per person, nominal, BGN														
2004	140.5	131.6	142.0	156.4	160.0	151.6	176.2						138.1	156.0
2003	125.2	116.0	130.1	135.5	143.2	141.9	147.1	151.1	153.1	154.9	153.4	197.9	123.8	140.2
Cash expenditure, monthly, average per person, nominal, BGN														
2004	136.3	128.4	136.9	146.8	148.0	140.7	163.2						133.9	145.1
2003	121.1	112.3	124.9	126.0	131.4	129.7	133.2	137.0	139.3	140.4	135.0	163.6	119.4	129.0
Real total income, monthly, average per person, growth, corresponding period of the previous year =100, %														
2004	3.1	3.9	3.1	4.2	3.3	-0.9	8.6						3.3	2.1
2003	11.6	7.9	7.5	8.7	5.5	11.1	12.2	6.3	2.0	3.0	7.0	2.0	8.9	8.5
Real cash income, monthly, average per person, growth, corresponding period of the previous year =100, %														
2004	3.0	4.6	3.5	3.1	2.7	0.9	0.9						3.7	2.2
2003	11.9	7.7	7.8	8.3	7.1	11.3	11.7	6.6	1.3	2.9	3.4	5.7	9.1	8.9
Real total expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %														
2004	5.5	6.4	2.8	8.8	4.6	-0.4	11.3						4.8	4.3
2003	12.4	3.3	8.3	8.9	3.1	7.3	7.9	3.7	0.1	4.3	3.1	1.9	8.0	6.4
Real cash expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %														
2004	5.8	7.2	3.3	9.8	5.4	1.1	13.9						5.4	5.4
2003	12.8	3.1	8.9	8.6	4.8	7.7	7.7	4.3	-0.4	4.6	3.4	5.9	8.2	7.0

1) Excluding credits to Monetary Financial Institutions.

2) Including credits to Non-financial Public Corporations.

3) Average monthly values by quarter are calculated as simple average of monthly per capita values.

Sources: Employment Agency, Bulgarian National Bank, Ministry of Finance, National Statistical Institute and own calculations.

Acronyms:

GDP = Gross domestic product

" - " = Not applicable or missing data

ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN OFFICIAL GAZETTE, No. 54 – No. 85

Title	Status	Official Gazette
RULES on the management of electricity distribution networks	New	No. 54/23.06.2004
Merchant Shipping CODE	Amended	No. 55/25.06.2004
ACT on the Bar	New	No. 55/25.06.2004
ACT on the Protection of Classified Information	Amended	No. 55/25.06.2004
Privatization and Post-privatization Control ACT	Amended	No. 55/25.06.2004
ORDINANCE on the regulation of natural gas prices	New	No. 55/25.06.2004
ORDINANCE on the regulation of thermal energy prices	New	No. 55/25.06.2004
ORDINANCE on the labeling requirements for new passenger cars in terms of fuel consumption and carbon dioxide emissions	New	No. 55/25.06.2004
CoM's DECREE on the coordination and monitoring of Republic of Bulgaria's preparation for accession to the European Union	Amended	No. 56/29.06.2004
CoM's DECREE on the set up of a Council for European Communication	Amended	No. 56/29.06.2004
ORDINANCE on the criteria, indicators and methodology of accrediting medical institutions	Amended	No. 56/29.06.2004
ORDINANCE on packages and package waste	Amended	No. 56/ 29.06.2004
MEMORANDUM of understanding on the use of the National ISPA Fund between the Government of the Republic of Bulgaria and the European Community	Amended	No. 56/29.06.2004
MEMORANDUM of understanding on the set up of a National Fund between the Government of the Republic of Bulgaria and the European Commission	Amended	No. 56/ 29.06.2004
ORDINANCE on the terms and procedure for participation of medical institutions in the international tissues and cells exchange	New	No. 57/2.07.2004
ORDINANCE on the terms and procedure of paying export subsidies upon export of agricultural products	Amended	No. 57/2.07.2004
ORDINANCE on the terms, procedure and methods of conducting environmental assessment of plans and programs	New	No. 57/2.07.2004
RULES on the implementation of the Excise Act	Amended	No. 58/6.07.2004
RULES on the implementation of the State Aid Act	New	No. 59/7.07.2004
CoM's DECREE on the salaries in budgetary organizations and activities	Amended	No. 60/9.07.2004
RULES on the structure and operation of the National Health Insurance Fund	Amended	No. 60/9.07.2004
CoM's Decision for adoption of a List of physical persons, legal persons, groups and organizations in respect of which measures under the Act on the measures against terrorism financing shall be applied	Amended	No. 61/13.07.2004.
ORDINANCE on the capital adequacy and liquidity of investment intermediates	Amended	No. 61/13.07.2004
METHODOLOGY on the terms and procedure of determining operators having significant influence on the market	New	No. 61/13.07.2004
CoM's DECREE on determining the bodies under Art. 41, Para 1 of the Act on the electronic document and the electronic signature	New	No. 61/13.07.2004
ORDINANCE on determining the rules of fixing and applying the prices of the services included in the universal postal service	New	No. 62/16.07.2004
ORDINANCE on the connection to the gas-transfer network and the gas-distribution networks	New	No. 63/20.07.2004
ORDINANCE on the terms and procedure of introducing restrictive regime, temporary termination or restriction of the production or supply of electricity, thermal energy and natural gas	New	No. 63/20.07.2004
ORDINANCE on the terms and procedure of importing and exporting hazardous chemical substances, preparations and products on the territory of the Republic of Bulgaria	Amended	No. 63/20.07.2004
Small and Medium-sized Enterprises ACT	Amended	No. 64/23.07.2004
Public Procurement ACT	Amended	No. 64/23.07.2004
CoM's DECREE on the organization, coordination and exchange of information about technical regulations and rules for information society services	New	No. 64/23.07.2004
CoM's DECREE on adopting Rules on the Structure and Organization of the Ministry of Finance and on the transformation and closing of administrative structures at the minister of finance	Amended	No. 64/23.07.2004
ORDINANCE on the registration and accounting of sales in commercial outlets	Amended	No. 64/23.07.2004
ORDINANCE on ozone Norms and alarm thresholds for ozone levels in the atmospheric air	New	No. 64/23.07.2004
ORDINANCE on ozone Norms in the atmospheric air	New	No. 64/23.07.2004
ORDINANCE on determining the indicators of differentiating the types of target influence regions	New	No. 64/23.07.2004
ORDINANCE on the terms and procedure of delivering radioactive waste to the State Enterprises "Radioactive Waste"	New	No. 64/23.07.2004
ORDINANCE on the requirements to the activity of investment intermediates	Amended	No. 65/27.07.2004
ORDINANCE on the content, structure, terms and procedure of submission of information by enterprises engaged in the extraction, processing and trade in fuels; transformation, transfer, distribution and trade in electricity and natural gas for the purposes of energy forecasts and planning	New	No. 65/27.07.2004
ORDINANCE on the procedure of investing the assets of supplementary pension insurance funds in foreign securities, on the types of securities and the requirements towards them and towards the regulated markets where they are traded	New	No. 65/27.07.2004
ORDINANCE on the documents required for issuing permits for transformation of pension insurance companies and of supplementary pension insurance funds, and on the requirements towards plans under Art. 327, Para 1, it. 3 and Art. 336, Para 1 of the Social Security Code	New	No. 65/27.07.2004
ORDINANCE on the terms and procedure of conducting the activity of the operators of the electric energy system and of the distribution networks, as well as of the operating personnel on duty in the electrical energy sites and the electric facilities of consumers	New	No. 66/30.07.2004

ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN OFFICIAL GAZETTE, No. 54 – No. 85

ORDINANCE on ensuring the safety of nuclear power plants	New	No. 66/30.07.2004
ORDINANCE on the terms and procedure of specifying the responsibility of the state and on curing the environmental damages resulting from past actions or failure to act, upon privatization	New	No. 66/30.07.2004
ACT on the 2004 State Budget of the Republic of Bulgaria.	Amended	No. 67/2.08.2004
ORDINANCE on the structure and safe operation of transfer and distribution gas lines and of the facilities, installations and appliances for natural gas	New	No. 67/2.08.2004
RULES on measuring the quantity of electric energy	New	No. 67/2.08.2004
RULES on providing access to the gas transfer and/or gas distribution networks	New	No. 67/2.08.2004
RULES on the trade in electric energy	New	No. 67/2.08.2004
RULES on the management of the electric energy system	New	No. 67/2.08.2004
RULES on the terms and procedure of access to the electricity transfer and distribution networks	New	No. 67/2.08.2004
ORDINANCE on fixing minimum prices in structural planning and investment design	New	No. 68/3.08.2004
ORDINANCE on thermal power supply	New	No. 68/3.08.2004
ORDINANCE on the volume and content of structural schemes and plans	Amended	No. 68/3.08.2004
ORDINANCE on pensions and the length of service for social security purposes	Amended	No. 68/3.08.2004
ORDINANCE on specifying the types of telecommunication activities subject to individual licensing and registration under general license	Amended	No. 68/3.08.2004
RULES on entries	Amended	No. 68/3.08.2004
ACT on child benefits	Amended	No. 69/6.08.2004
RULES on the implementation of the Act on the restoration of ownership over forests and land in the forestry reserve	Amended	No. 69/6.08.2004
RULES on the implementation of the Act on the ownership and use of farm land	Amended	No. 69/6.08.2004
ORDINANCE on the requirements for labeling, marking and attributes of tobacco products and on specifying standards for conducting compliance assessment of the content of harmful ingredients in cigarettes	New	No. 69/6.08.2004
Health ACT	New	No. 70/10.08.2004
Protection against discrimination ACT	Amended	No. 70/10.08.2004
Railway transport ACT	Amended	No. 70/10.08.2004
Civil Servant ACT	Amended	No. 70/10.08.2004
Value added tax ACT	Amended	No. 70/10.08.2004
Civil aviation ACT	Amended	No. 70/10.08.2004
Civil registration ACT	Amended	No. 70/10.08.2004
Waters ACT	Amended	No. 70/10.08.2004
Higher education ACT	Amended	No. 70/10.08.2004
Safe use of atomic energy ACT	Amended	No. 70/10.08.2004
Automobile transport ACT	Amended	No. 70/10.08.2004
Judiciary ACT	Amended	No. 70/10.08.2004
Tobacco and tobacco products ACT	Amended	No. 70/10.08.2004
Foods ACT	Amended	No. 70/10.08.2004
Waste management ACT	Amended	No. 70/10.08.2004
Environment protection ACT	Amended	No. 70/10.08.2004
ACT on the income taxation of physical persons	Amended	No. 70/10.08.2004
Public Health ACT	Amended	No. 70/10.08.2004
ACT on the marine spaces, inland waterways and ports of the Republic of Bulgaria	Amended	No. 70/10.08.2004
Local taxes and rates ACT	Amended	No. 70/10.08.2004
Medical institutions ACT	Amended	No. 70/10.08.2004
ACT on the administration of punishments	Amended	No. 70/10.08.2004
ACT on the health and safety at work	Amended	No. 70/10.08.2004
Health insurance ACT	Amended	No. 70/10.08.2004
ORDINANCE on the charges for public use of airports and for air navigation services in the Republic of Bulgaria	Amended	No. 71/13.08.2004
ORDINANCE on the terms and procedure of granting and withdrawing permits for industrial processing of tobacco and production of tobacco products	New	No. 71/13.08.2004
ORDINANCE on the terms and procedure of forming and applying tobacco product prices on the domestic market	Amended	No. 71/13.08.2004
ORDINANCE on the technical operation of electric power stations and networks	New	No. 72/17.08.2004
ORDINANCE on the safe management of radioactive waste	New	No. 72/17.08.2004
ORDINANCE on working hours, rests and holidays	Amended	No. 72/17.08.2004

ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN OFFICIAL GAZETTE, No. 54 – No. 85

RULES on the implementation of the Small and Medium-sized Enterprises Act	Amended	No. 73/20.08.2004
ORDINANCE on the terms and procedure of negotiating medicines the value of which is fully or partially payable by the National Health Insurance Fund	New	No. 73/20.08.2004
ORDINANCE on the basic Norms of radiation protection	New	No. 73/20.08.2004
RULES on the implementation of the Investments Promotion Act	New	No. 74/24.08.2004
ORDINANCE on the connection of producers and consumers of electric energy to the electricity transfer and distribution networks	New	No. 74/24.08.2004
ORDINANCE on the principles, inspection and certification of the Good Laboratory Practice	New	No. 74/24.08.2004
ORDINANCE on the terms and procedure of acquiring professional qualification and on the procedure of issuing licenses for special training and nuclear power practicing certificates	New	No. 74/24.08.2004
RULES on the structure and organization of the Commission for Protection of Competition	Amended	No. 75/27.08.2004
ORDINANCE on the fuel reserves	New	No. 75/27.08.2004
ORDINANCE on the labeling requirements for household appliances in terms of the consumption of electricity and other resources	Amended	No. 77/3.09.2004
ORDINANCE on the entry in the ship register	New	No. 78/7.09.2004
ORDINANCE on the terms and requirements for construction and operation of incineration installations and combined waste incineration installations	New	No. 78/7.09.2004
ORDINANCE on the state requirements for admitting students in the higher education schools of the Republic of Bulgaria	Amended	No. 78/7.09.2004
ORDINANCE on the activity of the operators of the gas transfer and gas distribution networks	New	No. 79/10.09.2004
ORDINANCE on specifying the basic package of health activities guaranteed from NHIF's budget	Amended	No. 79/10.09.2004
Concessions ACT	Amended	No. 80/14.09.2004
RULES on the implementation of the State Property Act	Amended	No. 80/14.09.2004
ORDINANCE on tenders and competitive tenders	Amended	No. 80/14.09.2004
ORDINANCE on the terms and procedure of special public procurement	New	No. 80/14.09.2004
ORDINANCE on the terms and procedure of issuing visas	Amended	No. 80/14.09.2004
ORDINANCE on the terms and procedure of holding negotiations with potential buyers	Amended	No. 80/14.09.2004
RULES ON THE STRUCTURE AND ORGANIZATION of the Executive agency for promotion of small and medium-sized enterprises at the minister of ecoNomy	New	No. 81/17.09.2004
ACT on the registration of people with disabilities	New	No. 81/17.09.2004
ACT on the protection, rehabilitation and social integration of invalids	Amended	No. 81/17.09.2004
Employment promotion ACT	Amended	No. 81/17.09.2004
CoM's DECREE on the set up of a Coordinating council on the National plan for development and coordination of the process of preparation of the program documents for participation of the Republic of Bulgaria in the Structural Funds and the Cohesion Fund of the European Union	Amended	No. 81/17.09.2004
ORDINANCE on the requirements to be satisfied by the sites for waste treatment facilities	New	No. 81/17.09.2004
ORDINANCE on the marking and commercial presentation of wines, alcoholic drinks and grape and wine products	Amended	No. 81/17.09.2004
ORDINANCE on the definitions of the types of alcoholic drinks, the rules for production of such drinks, permitted additives and conditions of use of such additives	Amended	No. 81/17.09.2004
ORDINANCE on the public procurement below the thresholds specified in Art. 7, Para 1 of the Public Procurement Act	Amended	No. 81/17.09.2004
ORDINANCE on the terms and procedure of provision of intermediation services by the Employment Agency to foreign employers for employment of Bulgarian nationals	New	No. 81/17.09.2004
ORDINANCE on the terms and procedure of keeping a Register of administrative structures and of the acts of the bodies of the Executive	New	No. 81/17.09.2004
RULES on the implementation of the Employment Promotion Act	Amended	No. 82/21.09.2004
ORDINANCE on the terms and requirements for construction and operation of depots and other facilities and installations for waste deactivation	New	No. 83/24.09.2004
RULES on the implementation of the Employment Promotion Act	Amended	No. 84/27.09.2004
RULES on the implementation of the Public Procurement Act	New	No. 84/27.09.2004
ORDINANCE on small public procurement	New	No. 84/27.09.2004
Insurance ACT	Amended	No. 85/28.09.2004
Health Insurance ACT	Amended	No. 85/28.09.2004
ACT on the Financial Supervision Commission	Amended	No. 85/28.09.2004
ORDINANCE on the terms and procedure of changing participation and transferring the accumulated funds of insured persons from one supplementary pension insurance fund to aNother corresponding fund, managed by aNother pension insurance company	Amended	No. 85/28.09.2004
ORDINANCE on the Central Depository of Securities	Amended	No. 85/28.09.2004
ORDINANCE on the terms and procedure of recognizing organizations of fruit and vegetable producers	Amended	No. 85/28.09.2004

A. GENERAL NOTES

The review of the Bulgarian economy is an authentic expert product of the Center for Economic Development, made possible mostly owing to the long experience of the Center in the field of applied studies of the economic policy and economic development of the country.

The present report on the Bulgarian economy follows the structure and content of the review established after the report on the second quarter of 2003. The objective of last year changes was to satisfy users' interest and to establish the publication as a source of reliable and comprehensive information about the economic development and the economic policy in the past months.

The review of the Bulgarian economy in the last months of 2004 contains detailed presentation of the review period, assessment of the period and subsequent trends. The review is not explicitly focused on one quarter of the current year. Where necessary, significant events, facts and data of periods before the start of the year have been highlighted. Where possible, two main types of data comparisons have been made: against the corresponding period of 2003 or against the end of 2003. Again where possible, the dynamics within the first nine months of 2004 has been traced, too. At many points also the short-term trend has been outlined.

The structure of the presentation above follows two principles simultaneously. First, the strive is towards giving a more comprehensive presentation of the subject matter areas, with corresponding prioritization of the range of matters discussed. Second, the different topics and analyses reflect the experience and interests of the experts and of the Center for Economic Development as a whole

The review of Bulgaria's economy in the last months of 2004 starts with presentation of the macroeconomic dynamics discussed against the background of the following basic categories: GDP, foreign trade, foreign direct investments, inflation, employment and unemployment. After that the latest values of the Estat index of business climate in Bulgaria are presented and compared. The national economic events in the reviewed period, which have direct or indirect effect on the competitiveness of the Bulgarian enterprises, are analyzed in the section on the enterprise policy. Such events are described in the sub-sections on encouragement of entrepreneurship, investment promotion policy, access to finance, effectively functioning markets, commercial policy and preparation for the single European market, privatization, regulatory regimes, public procurement regulation, combating corruption, index of economic freedom. In the specific Bulgarian economic environment the enterprise policy has two basic aspects – transformation, which is mostly associated with the process of privatization and liberalization of the economy, and competitive

orientation, which involves the policies to achieve economic growth and competitiveness of the Bulgarian enterprises. The corresponding section of the report studies problems concerning both aspects of the Bulgarian enterprise policy.

The public finance section covers the budget implementation and the fiscal reserve dynamics, the foreign and the domestic debt. The wide topic of social and healthcare policies encompasses the issues of social security, employment and unemployment, labor market policy, incomes and social partnership. A review is made of the current problems and condition of the healthcare reform. The environmental policy is discussed both as a specific element of the economic policy and as a factor for the economic environment

The financial sector is discussed by means of the banking system and the capital market. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria – energy, transport, high technologies and communications, tourism and agriculture. The section on regional policy studies the political decisions, facts and events relating to the achievement of balanced and sustainable development of the regions and reduction of the disproportions between them, as well as the process of social and economic cohesion with the European Union

The condition of the regulatory regimes applied by the bodies of Bulgaria's central and local administration is presented under the heading "In Focus" of the present report.

The annexes at the end constitute an integral part of the presentation. Annex 1 presents in detail the basic indicators for the first nine months of 2004. Annex 2 contains the list of newly passed legislation and amendments to laws, which are of significant importance to the economic development of the country, and have been promulgated in the Official Gazette in the period end of June – end of September 2004.

The work was finally completed on 15 October 2004.

B. SOURCES

Along with the conclusions from a large number of own outputs and works, some of which are parts of assigned research projects, the experts of the Center for Economic Development have used statistical and other information and data from the following basic sources:

- National Assembly
- Council of Ministers
- Ministry of Energy and Energy Resources
- Ministry of Agriculture and Forestry
- Ministry of Economy
- Ministry of Transport and Communications
- Ministry of Labor and Social Policy

- Ministry of Finance
- National Statistical Institute
- National Social Security Institute
- Employment Agency
- Agency for Small and Medium-sized Enterprises
- Privatization Agency
- Bulgarian National Bank
- Bulgarian Stock Exchange – Sofia AD
- Financial Supervision Commission
- Delegation of the European Commission
- European Union
- Eurostat
- European Bank for Reconstruction and Development
- Organization for Economic Cooperation and Development
- Official Gazette

The particular sources and publications are quoted at the respective places in the text.

C. THE ESTAT INDEX OF BUSINESS CLIMATE IN BULGARIA

The business climate survey is based on own original methodology, developed by the team of the Agency for Social and Marketing Surveys Estat and the Center for Economic Development. The more significant details are described below.

Methodology of the Sample

The survey was conducted in the period 1 – 20 July 2004 among the managers of 409 companies. The sample is a two-level panel one (at the first level the companies are divided into groups by regions, and at the second level – according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices “number of employees” and “type of ownership”. The sample is a guaranteed representative one at the level of going concerns.

Methodology of the Registration

The information has been collected using the method of an inquiry at the work place. The interviews were held with the owners of the companies covered by the sample, or with persons authorized to make management decisions and to sign financial statement documents (managers, chief accountants, commercial or marketing directors).

The questionnaire contains eight substantive questions and three passport questions. The integrated index is comprised of three components. The questions from one to five inclusive comprise Component I – “General Condition of the Company”; question six – Component II – “Investment Attitudes and Corporate Strategies”; questions seven and eight – Component III – “Business Environment”.

General Description of the Index Calculation

1. Preliminary preparation

The preliminary preparation includes weighting of the data according to the indicators “economic sector” and “number of employees”, recoding and calculating values for the respective questions.

- Questions with one possible answer

The original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done so as to have a scale from -2 (the lowest degree) to +2 (the highest degree).

- Multiple choice questions

These questions are recoded in advance so that possible answers are located symmetrically on both sides of the neutral point (the zero).

2. Calculation of the components

The index for each question (indicator) is calculated as a weighted average value.

Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component (“General Condition of the Company”; “Investment Attitudes and Corporate Strategies”; “Business Environment”) is calculated as a weighted average.

The first table above shows the values obtained for the three components and the integrated index.

3. Calculation of an integrated index

The integrated index is calculated as a weighted average of the three components. The weight for each of the components is determined by means of expert evaluation.

The Estat index of business climate assumes values from -100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German IFO Business Climate Index:

-100 to -61	very poor
-60 to -21	poor
-20 to +20	average
+21 to +60	good
+61 to +100	very good

Interpretation

All components (with no exception), as well as the integrated index, assume values within the interval [-100, +100]. The set of tools allows to determine also the direction of the index. The

difference between the values of questions Q3 (assessment of the expected condition), Q2 (assessment of the condition at a certain point in time) and Q1 (assessment of the condition during the preceding period) is applied as a criterion for determining the direction.

Beside everything aforesaid about the methodology, in many places throughout the text additional methodological and other notes and comments are given.

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EVENTS

Presentation of the publication “White Paper on Corporate Governance in South East Europe”



From left to right: M. Prohaska, Director for Development at the Center for Economic Development; David Robinett, Head of the OECD Corporate Affairs Division; Al. Boshkov, Co-Chair of CED Board of Trustees

On 1 July 2004 at the Information Center of the European Union, the Center for Economic Development and the Center for Corporate Governance (at the Post-Graduate Qualification Institute at the University of National and World Economy) presented the publication of OECD ‘White Paper on Corporate Governance in South East Europe’.

By preparing and presenting the publication, the Bulgarian team implemented the White Paper’s Recommendation 310 concerning its dissemination and presentation to Bulgarian business circles, general public and government administration.

The event brought together members of the investment community, banking circles, academic faculty members, parliamentarians, government members. The publication

summarized the work from OECD round tables held during the 2001-2004 period on corporate governance in the region.

The statements made by Mrs. Maria Prohaska, Doctor of Economics, and Prof. Bistra Boeva, Doctor of Economics, were focused on the team’s efforts to work for the improvement of corporate governance practices and the establishment of the appropriate institutional framework in Bulgaria.

Interest in corporate governance issues as part of the modern political and economic system was demonstrated by all actors: shareholders, company managers, pension and investment funds, consultants. The quest for more democratic corporate governance systems - systems aiming to bring forward shareholders’ interests - was emphasized in the statement of Mr. David Robinett, Head of the OECD Corporate Affairs Division.

Fiscal Decentralization in Bulgaria: Next Steps - Increasing the Autonomy of Local Government

On 13 and 22 September 2004 two meetings were organized between the Center for Economic Development representatives and external ad-hoc experts as part of the project “Fiscal Decentralization in Bulgaria: Next Steps - Increasing the Autonomy of Local Government”. The project is the result of the Center for Economic Development’s consistent efforts and successful initiatives to encourage the process on fiscal decentralization in Bulgaria. It represents a continuation of the project “Fiscal Decentralization - Focusing on Debate” implemented at the end of 2002-2003 which outlined the key issues and directions for future development of the process. Two years on, experts at the Center intend to use its results and conclusions as a springboard to direct specialized interest and public debate to specific practical aspects of decentralization.

Work on the project is focused on three basic topics: optimizing the revenue side of municipal budgets; measures to improve the effectiveness of expenditures; vertical and horizontal aspects of financial decentralization. In order to guarantee the practical value of outcomes, a survey held in October 2004 with representatives of local government, the central authority and local communities in six municipalities in the country served as the basis of analysis and recommendations. The municipalities were: Veliko Tarnovo, Nova Zagora, Montana, Plovdiv, Razlog and Ruse. Based on the survey results and the expert analyses three reports will be prepared in November–December 2004 (“Revenues Side of Municipal Budgets: Guaranteeing Sustainable Local Economic Development”; “Expenditures Side of Municipal Budgets: the Limits of Autonomy and Assuming Responsibilities”; “In Quest of Synergy: Horizontal and Vertical Aspects of Municipal Budgeting”). The project output and the report will be presented at the closing conference in February 2005 with the participation of local and foreign experts, representatives of the central and local authorities and organizational partners. The last stage of the project involves the publication and dissemination of conference materials and the organization of a series of media events to popularize the conclusions and recommendations.

Meeting of experts from Bulgarian non-governmental organizations

On 23 September 2004, the Center for Economic Development organized a meeting of experts from Bulgarian non-governmental organizations on issues of NGO development during Bulgaria’s EU pre-accession period. Representatives of organizations and analytical centers from Sofia and the country took part in the meeting; their fields of expertise included environmental protection, education, social activities, human rights, agriculture, fight against corruption, civil participation in local self-government, regional cooperation, women’s issues, development of entrepreneurship, youth policy etc.,

The meeting aimed to familiarize Bulgarian participants with the activity of similar organizations in Brussels providing specialized consultant and information services to the non-governmental sector.

The European Citizen Action Service – ECAS, Brussels, (www.ecas.org) and its projects to assist the non-governmental sector in the countries of Central and Eastern Europe were presented by Mr. Pavel Kelly-Tychtl, ECAS consultant for CEE.. The main topic of his presentation was “EU policy to finance activities implemented by non-governmental organizations and opportunities for lobbying before EU institutions”. The lecturer presented the specialized

annual ECAS publications on issues related to NGO financing through European programs and funds and the organization's training and internship program for NGO activists at European institutions.

Analyzing the problems of the Bulgarian NGO sector and its expectations about the tasks awaiting it in the years before the country's EU membership, participants in the meeting emphasized the sector's need for up-to-date information on EU institutions and the process of decision making by the Community's various representative bodies. Attendants were united around the idea that the successful participation of the non-governmental sector in the process of integration requires professional expertise, skills and excellent knowledge of the procedures and priorities in the implementation of common policies through the resolutions of the European Commission and the European Parliament. Participants also agreed that an accessible and efficient form of training is needed for NGO activists in Bulgaria on specific issues such as: opportunities for efficient representation and active participation of civil society in the decision-making process of European institutions related to national priorities in common European policies, the exchange of experience in good practices of lobbying in the EU, effective participation of Bulgarian organizations in European partnership networks. And last but not least, participants emphasized the lack of information about the priorities and activities of NGOs from EU Member States, opportunities for more active cooperation with counterpart Bulgarian organizations and the need for direct contact with such organizations. The hosts informed workshop participants the Center for Economic Development's intention to organize such meetings in the future and to continue its efforts on the issues of NGO experts' training and qualification jointly with its partners.

European Innovation Trend Chart

The second workshop of local correspondents under the European Innovation Trend Chart project was held in Brussels on 23 and 24 September 2004. The Center for Economic Development is implementing the project in Bulgaria and was represented Mr. Peter Stankov, Expert. The objectives set prior to the meeting were as follows: 1) to identify the progress made under the project and outline the challenges lying ahead; 2) inform project correspondents from participant countries on the development and improvements of Extranet - the information system established as part of the project; 3) to identify trends in the development of innovation systems in the six groups of countries included in the chart; these were presented by senior innovation policy consultants; 4) to start discussions between correspondents from groups of countries seeking better knowledge exchange between network members.

Progress on the project was reported by Mr. Christophe Guichard, DG Enterprise, European Commission, and by Alasdair Reid, Project/Network Manager. They reported that the Commission is preparing the publication of a new report on Member States entitled "Innovation Policy in Europe 2004". Emphasis in this report will fall on analyzing policies in individual Member States and not just on identifying individual actions the countries undertook. The report will provide analysis of the innovation policy trends in the EU based on the analysis of the European innovation system and reports by Innovation Chart countries. Another goal pursued with the report will be to analyze the innovation processes for each individual country; the report will also contain general conclusions and benchmarking opportunities for Member States.

Also announced was the establishment of a brand new "Framework Program on Competitiveness and Innovation"; its structure will be further clarified in 2005 and implementation will start in 2007.

The expanded capacity of the new Extranet information system was also presented at the meeting. The system provides the following options:

- virtual work environment for country correspondents;
- monitoring and content management tool;
- means of communication between Chart partners.

The countries participating in the project are divided into 6 groups – Big countries; Northern countries; South European countries; CEE countries; Small developed countries; Countries of Southeast Asia. Each group of countries has its senior innovation policy consultant; each of them delivered a presentation of the group characteristics and the specifics of individual countries in the development of innovation policy.

On the basis of reports drafted in advance by country correspondents, on the second day of the workshop a discussion was held with the following objectives:

- to establish the common characteristics of innovation systems between countries in the groups. These were outlined following a discussion that required prior knowledge of the reports by the other countries in the group.
- to summarize the good practices for each group which might be used for the internationalization of measures in economic policy. During the second part of discussion, on the basis of benchmarking criteria established in advance, each correspondent had to provide justification for at least one good practice in his/her country related to innovation policy.
- to practice the assessment of a given country's innovation system by another group. Each correspondent received in advance a report by the other group of countries with the analysis part missing. The objective of this practical training, third for the day, was to analyze innovation policy. For CEE countries, the report to be analyzed was the one on Austria.
- The results were to be presented to the remaining groups in a general meeting. Once group discussions were finalized, the main issues were presented to the other groups. Each group elected a representative to make a presentation of the group discussion results.

Closing meeting for the project “Involvement of Business in a More Efficient Fight against Corruption in Velingrad Municipality”



Closing meeting in Velingrad, 24 September 2004.

The closing meeting under the project “Involvement of Business in a More Efficient Fight against Corruption in Velingrad Municipality” was held on 24 September 2004 at the Business and Information Center in Velingrad. The project was implemented by the Center for Economic Development with cooperation from the local partner “Regional Development Agency - Velingrad”. The project is part of the program “Civil Society Against Corruption” implemented by “Coalition 2000” with USAID financial support.

The closing meeting brought together local government representatives – including the Velingrad Municipal Council Chairman Mr Nedjat Kehayov, municipal councilors, businessmen, representatives of the Economic Police, “Bulbank”

AD, the Labor Bureau, business centers created under the UNDP Jobs program, regional print and electronic media.

The purpose of the meeting was to share and disseminate to other Bulgarian municipalities the experience Velingrad municipality obtained in the establishment and application of a practical mechanism to counter corruption through public-private partnership with the more active involvement of businesses.

Participants were introduced to the project course and outcomes, the importance of the Charter Against Corruption signed by local government representatives, businessmen, citizens, and media as part of the anti-corruption forum held in June. At the meeting, special emphasis was given to the business community's involvement in the fight against corruption and its adverse impact on business development. Figures from the July ESTAT business climate index presented to the forum participants confirmed these conclusions. It is only businesses' active awareness of their role in this process that can give additional impetus to the efforts by a number of other organizations and institutions to cut down on corruption in Bulgaria.

The need to upgrade the administrative and regulatory environment for business development was also discussed during the three-hour meeting. The Center for Economic Development team additionally emphasized the anti-corruption potential of the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity, and the new Public Procurement Act. Also discussed was the need to improve business people's awareness and knowledge of legal matters.

The Municipal Council Chairman, Mr Nedjat Kehayov, spoke of the local government's role in the fight against corruption. He emphasized the importance of the Charter Against Corruption as a document of moral value that would help citizens come together and stand up against corruption.

The idea that with the completion of the project at the end of September the Civil Initiative Committee (CIC) should continue its activity was given support at the meeting; efforts should continue through the further popularization of the Charter Against Corruption and other anti-corruption initiatives. CIC was set up in March 2004 to draft and adopt the Charter Against Corruption.

The Charter is a document open to anyone ready to accept its principles. The document can be signed at the Business and Information Center and also in the Town Hall - it is kept with the Municipal Council Chair's office.

Workshop on “Sustainability of Agriculture in Enlarged Europe under the Reformed CAP”



Opening of the workshop in Seville, 23 September 2004.

On 23 and 24 September 2004 in the city of Seville, Spain, an expert workshop for Member States and EU candidate countries was held on issues of sustainable agricultural development under the conditions of the reformed Common Agricultural Policy (CAP). The workshop was hosted by the Institute for Prospective Technological Studies (IPTS) – one of the seven members of the European Commission's Joint Research Centers. The workshop aimed to evaluate the impact of the reformed CAP (is expected to come into force in 2007) on the capacity of individual countries to preserve the sustained development of their national agriculture.

On the background of trends in the global development of agriculture in dynamically changing transition countries presented by Prof. Mazoyer of the Institute National Agronomique (France) and Dr. Paolo Groppo of FAO, workshop participants assessed of individual aspects of the reformed CAP on national economies. The IPTS hosts presented the results of a two-year study of the structure of agricultural production for five countries in transition: Latvia, Poland, Hungary, Czech Republic and Romania. The scope of the study covered as follows: the income level in the sector and the possible impact of the reformed CAP; which production units would be able to continue functioning without Community support; will the agricultural sectors of new Member States and candidate countries manage to keep their market share in an enlarged EU; will the support from CAP delay the restructuring in the sector.

The Center for Economic Development was represented at the workshop by Mrs. Marieta Tzvetkovska, Senior Expert. Her presentation aimed to illustrate how Bulgarian agriculture deals with the challenges and what impact the reformed CAP would have on its sustainability, on the future rural development, on the restructuring process aiming to reach EU standards and expand positions in the Single European market.

The workshop was attended by representatives of FAO, the European Commission, universities, specialized institutes, academies, non-governmental organizations. Presentations made at the workshop are available on: http://www.jrc.es/home/events/workshop_sept_04.htm.

MEETINGS “ON THE ROOF”

Discussion of the idea for NSSI capitalization

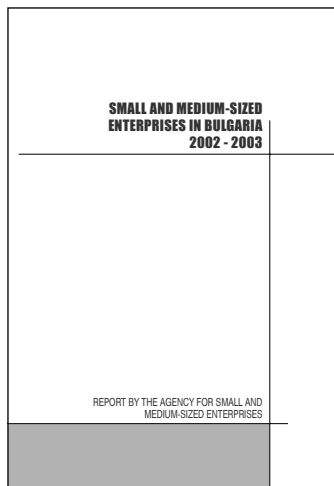
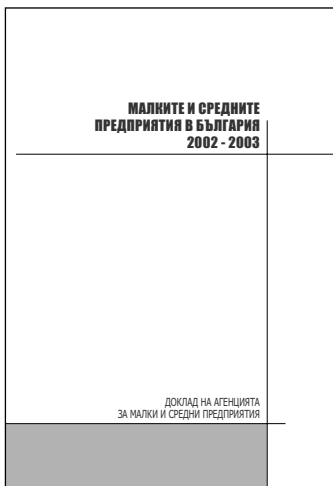


Meeting in the “Roof Hall” with Mr. Ivo Prokopiev (center), Chair of the NSSI Supervisory Board and Co-Chair of the Union of Employers.

The Center for Economic Development management and expert team held a meeting with the new Chair of the Supervisory Board of the National Social Security Institute (and Co-Chair of the Union of Employers) Mr. Ivo Prokopiev on 6 October 2004 at the “Roof Hall”. The purpose of the meeting was to discuss Mr. Prokopiev’s idea on NSSI capitalization with the CED, the latter being one of the champions of pension reform in Bulgaria.

The essence of Mr. Prokopiev’s idea is to channel fiscal reserve funds to the NSSI and manage these funds in the long term horizon in order to generate ongoing annual revenues that would allow for pensions to be raised by about 10 per cent while insurance contributions are lowered by about 4-5 points. The Center for Economic Development backed in principle Mr. Prokopiev’s idea and proposed that it be analyzed in detail by experts and put up for wide public debates.

NEW PUBLICATIONS



The report entitled “Small and Medium-Sized Enterprises in Bulgaria 2002-2003” was published in August and September 2004 in Bulgarian and in English respectively. The report was prepared by Center for Economic Development experts under assignment by the Agency for Small and Medium-Sized Enterprises. It was financed by the United States Agency for International Development

The research paper aimed to present the current situation of the SME sector, outline its role and contribution to the country’s economy, and analyze opportunities and barriers to SME development in several key areas – administrative and regulatory environment, access to financing, information.

Chapter One of the report introduces the SME sector in Bulgaria based on quantitative data supplied by the NSI. The figures allow for a comparative study to be made thus identifying the position of SME in the country’s economy and in the non-financial sector. Key indicators such as the SME share in GDP, gross added value, job-generation, foreign direct investment, export and import are analyzed; the per-employee productivity is also discussed. Data by industry and by planning regions were also included.

The second objective - review of the environment for SME development in several key areas - is pursued in the subsequent chapters of the report. Current events, facts, legislative changes, strategic and programmatic documents for each of the reviewed areas were also reported. An

attempt was made at assessing the impact of these events on SME behavior; conclusions and recommendations were put forward.

Chapter Two provides an overview of the institutional framework for the sector's development. The European Charter for Small Enterprises – a document setting the key priorities in this area - was used as a point of reference. An overview of government policy in the SME area was also included with special emphasis on the framework for SME development – strategies, programs, legislation.

Chapter Three contains an overview of the administrative and regulatory environment for SME development with emphasis on regulatory procedures, anti-trust measures, SME access to public procurement contracts, settling of legal disputes, counteraction against corruption practices.

Following the key priorities of the European Charter for Small Enterprises and in line with the EU policy priorities, Chapter Four provides analysis of the SME access to financing. Various options are provided for access to financing, including banks' interest in SME financing, alternative sources of financing - capital market, leasing, guarantee facilities, government, non-governmental and international programs, and informal sources.

Chapter Five provides analysis of SME access to information and outlines the role of IT and opportunities to use it in such enterprises. Special emphasis is given to hi-tech SMEs and business incubators in support of start-up companies. E-government services provided to businesses are described.

Chapter Six is devoted to the quality of company strategies - an issue which, along with the business environment, is of particular significance to companies' competitiveness. The discussion is focused on SME internal resources and development priorities. Also discussed are factors such as information resources and marketing strategies, the use of IT, the quality of management, human resource policy, and SME adjustment to the requirements of European markets. The analysis is based on results from a survey of SMEs and further clarifies the situation of the sector as illustrated by the statistical data.

Each chapter of the report finishes off with a summary of the current problems and provides recommendations.